1 BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

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

9 - - -

10 PROCEEDINGS

11 before Ms. Christine Pirik and Mr. Gregory Price,

12 Attorney Examiners, at the Public Utilities

13 Commission of Ohio, 180 East Broad Street, Room 11-C,

14 Columbus, Ohio, called at 9:00 a.m. on Friday,

15 October 17, 2008.

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17 VOLUME II

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Friday Morning Session,

October 17, 2008.

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EXAMINER PIRIK: Okay, we will go back on the record. This is day two in 08-935-EL-SSO.

Good morning, Mr. Warvell.

THE WITNESS: Good morning.

EXAMINER PIRIK: I believe --

MR. PORTER: Your Honor, if you wouldn't mind, we would like to make for the Association of Independent Colleges and Universities of Ohio, unless you would like to do it later today, that's fine, but if we could, with agreement of parties, maybe we could handle the appearance and the accepting the Association to intervene as a party at this time.

EXAMINER PIRIK: Mr. Burk.

MR. BURK: That's fine, if you want to go forward now.

MR. PORTER: I just wanted to make a

20 brief statement for the Association.

21 Just a quick background, it's 51 private

22 independent colleges and universities across the

23 state, several members have campuses within the

24 FirstEnergy territory.

25 The Association recently learned of these

1 proceedings and simply needs to get a seat at the
2 table. There's no intent and the Association will
3 not file -- file expert testimony, nor will it
4 cross-examine -- the Association will not file expert
5 testimony or cross-examine witnesses for the
6 proceeding.
7 And we have no intent nor will we appeal
8 the matter or file a post-hearing brief. We simply
9 want a seat at the table.
10 We don't intend to create any extra work
11 for anyone here, so if we could get a seat to the
12 table, or if we are crowded, a seat in the back here
13 will be fine.
14 And if it's fine the with parties and the
15 company, without the objections we would appreciate
16 the ability to intervene.
17 EXAMINER PIRIK: Thank you.
18 Mr. Burk.
19 MR. BURK: I would say with Mr. Porter's

20 representations on the record, we wouldn't oppose the

21 intervention.

22 EXAMINER PIRIK: Are there any other

23 comments or objections?

24 MR. SMITH: I would just make the comment

25 participation is so limited, I wonder what the

purpose is.

MR. PORTER: The purpose, again, is to intervene on behalf of the schools. Again, to ensure that the -- to ensure that at least the interests of the schools are represented within the proceedings, and there will be a number of ways, not through cross-examination, that we will intend to ensure that those interests are met.

MR. SMITH: Thanks for the clarification.

EXAMINER PIRIK: Thank you, Mr. Porter.

MR. PORTER: Without the objection I would like to enter the appearance of the law firm of Schottenstein, Zox & Dunn, attorneys Andre Porter, Chris -- Christopher L. Miller, and Gregory Dunn on behalf of the -- on behalf of the Association of Independent Colleges and Universities of Ohio.

EXAMINER PIRIK: With that appearance and the motion, we will grant the motion of the Independent Colleges and Universities of Ohio with

20 respect to the manner in which they intend to proceed

21 in this proceeding. As stated by Mr. Porter, we will

22 grant their intervention request.

23 MR. PORTER: Thank you, your Honor.

24 EXAMINER PIRIK: Anything else

25 procedurally on the record we need to go over before

we start?

Hearing none, I will turn to Nucor.

MR. STONE: Thank you.

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CROSS-EXAMINATION

By Mr. Stone:

Q. Good morning, Mr. Warvell.

A. Good morning.

Q. I believe we got a chance to talk a week or two ago in the deposition that was conducted. Do you recall that?

A. Yes.

Q. Okay. Pleasure to talk to you again.

First, I want to talk to you a little bit about the transmission and ancillary services rider in your recovery of transmission and ancillary services costs in this case.

MS. McALISTER: Your Honor, excuse me, we are having a little trouble hearing you at this end.

MR. STONE: Sorry about that.

EXAMINER PIRIK: That's fine.

MR. STONE: Technology compromised here.

Q. Let's try that again.

It's a pleasure to talk to you.

Let's talk a little bit about the

transmission costs recovery approach that you propose.

Correct me if I am wrong, but what you are doing is you are taking the total transmission costs and you are dividing them between those you believe are demand related and those you believe are energy related, correct?

A. Yes, that is true.

Q. Okay. And how did you decide which ones were demand related and which ones were energy related?

A. Based on the billing process of MISO.

Q. So on the demand-related ones, what -- can you be more explicit on what you looked at to decide they were demand related? How are they recovered on a demand basis?

A. Based on how they are billed from MISO.

Q. And they are billed from MISO based on the 12 coincident peaks?

20 A. Monthly peaks, I believe so, yes.

21 Q. And that would be the question of peaks

22 of FirstEnergy?

23 A. Of our control area.

24 Q. Your control area, yeah, okay.

25 And then the income-related costs, how

did you -- how are they billed by MISO?

A. Based on the load-serving entity or the EDU by the megawatts.

Q. Are they -- do they vary based on the time of day or season?

A. It bases on the tariff that it would be applicable to.

Q. So some of them may?

A. Some do, yes.

Q. Some do, okay.

Now, in a recovery of -- so let me back up and say in your tariff you indicate you would -- that each year you would go through and determine what these costs were and allocate them, correct?

A. They are in a forecasted basis.

Q. For now but you are going to reconcile them, correct?

A. Reconcile them in the process, yes.

Q. So as a result, what tariff or what

20 document tells you how it is if you are going to

21 allocate those in the future?

22 A. I am not understanding your question, I'm

23 sorry.

24 Q. What -- what is the -- you've chosen a

25 certain method to allocate certain of these costs of

demand related and certain of these cost as energy related for purposes of your initial tariff that's going to take effect on January 1, 2009, correct?

A. Yes.

Q. In calculating the charges in the future between 2009 and 2011, where in your tariff does it tell you how you are going to allocate those things, or does it?

A. Once again, I am not understanding.

Are you asking are we going to use history to base our forecast as far as the demand charges? Is that what your question is?

Q. No. Let me try it this way.

First question is I presume you are going to allocate them in the future based on the same method you allocated them in your proposed 2009 tariff?

A. That is true, yes.

Q. So you would allocate the ones that you

20 believe are demand related based on demand and the

21 ones you believe are energy related based on energy?

22 A. Yes.

23 Q. Is it possible that any of the categories

24 that are allocated based on energy today you might

25 change to demand, or vice versa?

A. It would depend on how MISO is billing that product, yes.

Q. Okay. And I guess what I was asking you is I understand what you would like to do, but where in the tariff does it say you will allocate it in that fashion, or does it?

A. That we would change?

Q. No, that you would allocate it in any particular fashion.

A. I believe, as we stated before, we'll base it on how MISO bills us.

Q. Okay. Well, I was just reading the tariff and it said the -- it says your -- your transmission costs are the amount of the companies' total projected transmission and ancillary services-related costs for the computation period allocated to each rate schedule.

EXAMINER PIRIK: Could you give us a site from the page you are reading.

MR. STONE: I'm sorry, the one I am reading are rider TRS ancillary services rider, and it's the first page. This particular version happens to be Schedule 3B, 4 of 20, original sheet 83, but I believe it's same in all the transmission and ancillary service riders.

Q. And I was just asking is there anything in the rate schedule that prescribes how it is you are going to allocate these costs that you are aware of?

A. Other than the way I have just described it, no.

Q. Okay. So what you have just described, though, is what you intend to do but that what you just described is not specifically in the tariff, is it?

A. No, other than the posting of how the expenses are laid out as far as energy and -- energy and demand is how it's broken down by schedule. Other than that, no.

Q. Yeah, okay. Now, roughly -- would you agree with me that roughly a little over half of the expenses for transmission that you -- the projected ones at least were demand related and a little less than half were energy related based on your

classification?

A. Since the numbers in the filing are not specific, I would say based on the numbers that are listed here, that, yes, roughly it's about 50/50.

Q. Okay. Maybe a little bit more demand though.

A. Yes, but since these numbers are not specific to our current filing, I would -- I would say what we've listed from an illustrative example, I would agree with your statement, yes.

Q. All right. Now, in recovering these transmission and ancillary services costs, you elected to recover from some classes based on kilowatt hours and other classes based on kVA of demand, correct?

A. Yes.

Q. For example, in the GT class you elected to recover them based on kVA demand, correct?

A. Yes.

Q. So the way this works is that -- is that you are going to allocate the costs a little over 50 percent -- if that proves true in the future, a little over 50 percent of them based on demand and a little less than 50 percent based on energy, but when you get to the individual classes, some classes are

20 going to collect it based entirely on energy, and

21 some of the other classes you are going to collect it

22 based entirely on demand, correct?

23 A. Yes.

24 Q. Now, second -- the demand piece of this,

25 you agreed with me, was incurred as a result of your

coincident peak demands, correct?

A. For the control area load, yes.

Q. Right. So that would occur during on-peak times?

A. Yes.

Q. But -- I am not criticizing, just understand, but you nonetheless decided to recover it from the people in the GT class based on their demands whenever they occurred, correct?

A. It would be based on their demands throughout -- throughout the time period, yes.

Q. So, in other words, some customer -- if their demand happened to be the highest at 3 o'clock in the morning on one day of the month for that month, that's the demand you would use to calculate what their contribution would be to these transmission costs --

A. Yes.

Q. -- correct?

Now, is FirstEnergy -- is -- are the operating companies or is FirstEnergy Solutions responsible for their transmission costs in this case?

A. It would be based on the load-serving entity, which would be the operating companies.

Q. So you would be directly billed for these, and you would be directly passing them through.

A. When you say "you," it would be the operating companies.

Q. You, the operating companies.

A. Yes.

Q. Okay. All right. Let's turn for a moment to the -- oh, by the way, one more question before I do that.

Would you agree with me the demands that are billed for transmission customers -- excuse me, the demands that FirstEnergy is paying for its transmission service to MISO or to whomever you are getting service from are 60-minute measured demands?

A. MISO bills on a 60-minute demand level for control area, yes.

Q. And the demands that you are proposing to measure for GT and other classes are 30-minute

20 demands, correct?

21 A. Yes. We are billing on 30-minute demands

22 to tie in with our distribution billing process, and

23 truthfully, that is more something that Greg Hussing

24 could talk to as far as why those need to be

25 coordinated together.

Q. But what you are saying is in part you are doing -- since you are proposing the transmission, what you are saying is in part you want the consistency of the billing part so that's what you are using for transmission as well?

A. Yes.

Q. Now, if we could turn to talk a little bit about rider CCA. I believe you talked a, little bit about it yesterday, but I have a couple of questions about it.

And this rider is to recover potentially some additional capacity costs incurred between May 1 and September 30 of each year, correct?

A. I'm sorry, could you repeat that question.

Q. This rider is designed to --

A. I was just going to have her read it.

Q. I am perfectly willing to. I may say it differently, but anyway, this rider is designed to

20 recover potentially -- any potential additional

21 capacity costs that might be incurred between, what

22 is it, May and September of each year?

23 A. As far as what you are saying is capacity

24 costs, the way this is laid out it's not directly

25 capacity costs, so it would be the planning reserve

1 requirement for the operating companies' load
2 responsibility.
3 Q. A portion of that cost associated with
4 meeting that planning reserve, correct?
5 A. Yes, I would agree with that.
6 Q. And to meet that planning reserve, if I
7 understand you correctly, the -- part of that
8 planning reserve is being met, hopefully, by
9 FES-owned units, correct?
10 A. Yes.
11 Q. But, right now, we don't know -- first,
12 we don't know if there is going to be a planning
13 reserve requirement, do we?
14 A. We don't know a specific number as of
15 yet. I would agree with that statement. MISO has
16 not come out and said it's going to be 15 percent, 20
17 percent, 10 percent.
18 They have not claimed what that's going
19 to be, but they are in the process of deciding that

20 there is going to be a planning reserve.

21 Q. And assuming they decide there is going

22 to be one and assuming they set a number, then this

23 is the process -- this being rider CCA is the process

24 for recovering the costs above what -- above the

25 planning reserve that FirstEnergy Solutions already

has in place?

A. Above the capacity in which they would serve the load, yes.

Q. Right. How would you -- how would they acquire the capacity -- do we know how they would acquire the capacity May through September if their units are not sufficient?

A. That would have to be done through a bilateral purchase.

Q. Okay. Have they done that so far? Do you know?

A. I believe, as we stated in some of the workpapers, that they have bought some DNR for 2009 roughly at $64 per megawatt day.

Q. Have they bought any -- have they -- do you know if they bought enough for 2009?

A. I don't know what "enough" would be, and I'm not privy to that information.

Q. So you don't know?

Do you know if they bought any for 2010 or 2011?

A. I'm not aware.

Q. Okay. Do you know -- what happens if they don't have sufficient DNR?

A. I don't understand your question, I'm

sorry.

Q. Let's assume FirstEnergy Solutions doesn't have sufficient designated network resources to meet the capacity of MISO, assuming there is one. What happens? Is there a penalty?

A. MISO would levy a penalty. That's what the initial rules are stating that haven't been approved yet.

Q. And the penalty is fairly large?

A. I don't specifically remember every penalty, but I believe it is quite large.

Q. Now, in the event that FirstEnergy Solutions, for whatever reason, failed to acquire sufficient DNR under this rider, would we be responsible for the penalty, "we" meaning the customers -- would the operating companies be responsible for the penalty first?

A. That is not the way the application is laid out in the charge now.

20 Q. So what you are saying is if they failed

21 to acquire sufficient DNR, FirstEnergy Solutions is

22 responsible for that?

23 A. With, once again, going back to many

24 conversations from yesterday, depending on how the

25 contract would be laid out between the companies, the

1 risk is falling on either the operating companies or
2 FES in consideration with your question.
3 Q. Okay. So, right now, we don't know
4 because there is not a contract; is that what you are
5 saying?
6 A. I'm saying who is responsible in the risk
7 we don't know.
8 Q. Okay. When your rider says, and I am
9 referring to your rider CCA Schedule 3B, what I am
10 looking at is 3B, page 18 of 20, it says the CC,
11 which is the -- I believe it's the capacity cost.
12 It says "= the Company's projected costs
13 for capacity purchased to meet the planning reserve
14 requirements for the period May 1 through
15 September 30 of each calendar year" --
16 A. I'm sorry, I am nowhere near where you
17 are.
18 Q. I'm sorry. You didn't have to look at
19 it, but you are welcome to. I'm sorry, it's Schedule

20 3B, page 18 of 20. It's basically rider CCA, the

21 first page.

22 A. Okay. I have it.

23 Q. Any version of it I think would work.

24 A. Okay. I have rider CCA and it's document

25 sheet 111.

Q. Yeah, it says -- I'm sorry.

MR. KUTIK: Your Honor, perhaps on behalf of the court reporter I could ask Counsel to let the witness finish his sentences, and if the witness could let Counsel finish his sentences, I think that would help everyone.

EXAMINER PIRIK: Yes. Why don't we wait.

Are you on the correct page?

THE WITNESS: I don't know.

EXAMINER PIRIK: Do you have a copy of the page you can show him?

MR. STONE: I can show him the one here.

Q. (By Mr. Stone) Let me ask you, do you have original sheet 111?

A. Yes.

Q. Yes. I think we are in the right place.

A. Okay.

Q. Rider CCA. And where the sheet says, about a third of the way down, "CC = the Company's

20 projected losses," are you there?

21 A. "Projected costs," yes.

22 Q. "Projected costs," I can't see without my

23 classes.

24 "...projected costs for capacity

25 purchased...." All right.

My question to you is, reading that language, what are the companies' projected costs? You said the projected costs for 2009 were a dollar -- were $64 a megawatt -- $64 a megawatt per hour?

A. Per megawatt day.

Q. Per megawatt day, so is that the projected costs that are used in this sheet that --

A. I'm not understanding --

Q. I'm sorry, what projected costs would be used here?

A. It would be the projected costs of FE's requirement based on the forecasted load if they were short.

Q. But you don't have that at this point.

A. No. Number one, as you stated earlier, we don't know what the planning reserve requirements are going to be. We also are not sure what the load forecast would be effective for this time period in

20 2009 to calculate that number.

21 Q. And you are not sure of what the costs

22 will be?

23 A. That is also a true statement, yes.

24 Q. Okay. Now, would this language allow you

25 to -- back up. Would this language allow you to pass

through any penalties in your view?

A. No.

Q. Okay. Now, this language suggested it will be an amount allocated to each rate schedule. How is it allocated to each rate schedule?

A. It will be allocated the same way as the transmission is allocated; certain classes on demand and certain classes on kWH.

Q. I don't mean how is it recovered. I don't know if you want to correct what you just said or not, but you said it would be allocated to some classes based on kilowatt hours and some classes based on demand.

I understand you are recovering it based on kilowatt hours and demand depending on the class, but how are you allocating it to each rate schedule?

A. It would be based on total dollars, megawatt hours.

Q. So you are allocating it based on --

20 A. Megawatt hours.

21 Q. Megawatt hours, on energy, in other

22 words.

23 A. Yes.

24 Q. So even though the cost is being incurred

25 based on meeting capacity needs, you are allocating

it based on energy?

THE WITNESS: I'm sorry, could you read that question back again.

(Record read.)

A. Yes, I believe so.

Q. Okay. Why wouldn't you treat this the same way you treated the transmission demand-related costs since these are demand-related costs as well?

A. I don't have that answer, sorry.

Q. Would you have a problem allocating it based on demand -- excuse me, based on demand instead of energy?

A. No.

Q. So that would be a reasonable approach?

A. Yes.

Q. Now, lastly, the schedule itself doesn't dictate how it's going to be allocated, correct? It just says "allocated to each rate schedule"?

A. I'm sorry, I am not -- where are you?

Q. I'm sorry, going back to the rate schedule itself, rider CCA, original sheet 111.

A. Okay.

Q. It doesn't appear, to me anyway, and correct me if I am wrong, this sheet doesn't indicate how you are going to allocate these costs of

capacity. It just simply says they will be allocated to each rate schedule, correct?

A. No. They will be allocated as shown by kWH and billing demands for GS, GP, GSU, and GT.

Q. I'm sorry, we are having a problem with words, and if you look under CC, it says "Where CC =" same sheet, and it goes down and the sentence says "projected costs," so on and so forth, at the end "allocated to each rate schedule."

So you are -- as I read this, you are going to allocate costs to a rate schedule and then you are going to divide them by the billing units in the rate schedule which in some cases is demand and some cases is energy, and then you are going to calculate a rate, correct?

A. Correct.

Q. And in terms of the allocation, not the recovery through the rate, the allocation to each rate schedule, does this tell you how you allocate it

20 to the rate schedule?

21 A. No, it does not.

22 Q. It does not. So what you have told me is

23 the plan when you described to me how it was going to

24 be allocated, you described to me what was the plan

25 of how you would allocate it, but it is not

specifically prescribed in the rate schedule.

A. It is not prescribed in the rate schedule.

Q. Thanks.

Now, again, in this case would you agree with me that these capacity costs -- or these costs for undercapacity costs, it's called a capacity cost, the capacity cost adjustment rider, are actually incurred based on projected on-peak basically coincident peak demands.

THE WITNESS: Could you read that question back again, please.

(Record read.)

A. Yes.

Q. Okay. Now, despite the fact they are coincident-peak or on-peak demands, and leaving aside the allocation we just talked about, and talk about recovery for a minute, you are going to collect it from some classes based on kilowatt hours, correct?

20 A. Yes.

21 Q. And other classes you are going to

22 collect it based on noncoincident-peak demand,

23 correct, each individual customer's billing demand?

24 A. Yes.

25 Q. And that billing demand, again, like we

1 discussed earlier, could occur -- doesn't have to
2 occur during the peak period in which the capacity
3 costs are actually incurred; it could occur in an
4 off-peak period?
5 A. Yes.
6 Q. Okay. And, again, you are doing this
7 for -- the recovery part for consistency, similar to
8 the answer you gave me on the transmission costs?
9 A. I'm sorry.
10 Q. You said -- you said on the trans -- on
11 the recovery of transmission, even though it was
12 incurred based on coincident peak, you are recovering
13 it from some classes like GT based on the peak
14 whenever it occurs for consistency with your billing
15 demand measurement?
16 A. Yes.
17 Q. Correct?
18 And you are doing the same thing for
19 consistency under this rate schedule?

20 A. Yes.

21 Q. Is it fair to say that wherever you

22 calculated a demand charge throughout your tariffs

23 for consistency, you tried to be consistent with

24 using the same billing demand measurement?

25 A. Yes.

Q. Consistency is important.

A. I believe so, yes.

Q. In this instance, I'm sorry. Yeah, okay.

Now, would -- under rider CCA -- when you are doing your projected requirements for capacity to decide whether you have to acquire this additional capacity that you would then be charging through rider CCA, would those demands that you are trying to -- trying to meet for this extra capacity exclude interruptible loads?

A. The portion, yes, that we would be turning in to MISO as far as the peak demand, yes.

Q. Would exclude interruptible loads?

A. Would exclude a portion of the interruptible load, yes.

Q. In other words, the interruptible load would not -- there would be -- to a degree there is interruptible and that interruptible demand would not be in the demand you are turning in to MISO?

20 A. Correct.

21 Q. Okay. Do you propose to charge rider CCA

22 to interruptible customers?

23 A. Yes, because the interruptible customers

24 also have a firm load.

25 Q. Okay. Do you propose to charge CCA to

interruptible customers for their interruptible load?

A. Yes. It's based on their total demand.

Q. Would it be reasonable not to charge them for their interruptible load since they are not on the peak during this time because you have excluded them?

A. That is not how we have proposed it.

Q. I know, but would that be a reasonable approach?

A. It's one approach, and I don't know if it's reasonable or not.

Q. All right. Now, let's switch gears and talk about your interruptible proposals here.

You've proposed -- "you" meaning FirstEnergy, the operating companies, have proposed two interruptible tariffs; is that correct?

A. Yes.

Q. You proposed a rider ELR and a rider OLR, correct?

20 A. Yes.

21 Q. And you are the witness that is

22 responsible for supporting and sponsoring rider ELR

23 and rider OLR?

24 A. Yes.

25 Q. Now, now the difference between ELR and

OLR, let's get that on the table first. First, they start out with the same interruptible at $1.95, correct?

A. For the emergency load, yes.

Q. Yeah. But also the credit in your rider ELR is $1.95 as well, correct?

A. Yes.

Q. Now, ELR -- OLR is -- only allows the company to have emergency interruptions, correct?

MR. KUTIK: May I have the question read, please.

(Record read.)

A. Yes.

Q. Whereas, ELR allows for emergency and economic interruptions, correct?

A. Yes.

Q. Okay. Now, if there is an economic interruption under ELR, the customer can buy through, correct?

20 A. They have that option, yes.

21 Q. If they choose to buy through, they pay a

22 higher price, correct, than they would for just

23 regular energy under the rate schedule?

24 A. Yes.

25 Q. Okay. In fact, you can only call an

1 economic interruption under rider ELR if the price --
2 the buy-through price is going to turn out to be
3 higher than the price under the rate, correct?
4 A. Under the generation rider less the
5 phase-in, yes.
6 Q. Okay. And ELR -- never mind.
7 Are there -- well, that's okay. Let's
8 start with the emergency interruptions.
9 Under ELR there -- what it basically
10 allows is the company discretion to determine whether
11 there is a need for an emergency interruption,
12 correct, ELR or OLR for that matter?
13 A. Based on the reliability of the system.
14 Q. Right. So for -- if there is a
15 reliability concern for the system, the company is
16 allowed to interrupt service on 10 minutes' notice to
17 either the ELR customers or the OLR customers,
18 correct?
19 A. Yes, that is true.

20 Q. So presumably only customers who can cut
21 their service off in 10 minutes and respond to this
22 signal should be taking service under these tariffs?
23 A. Yes, that's one of the requirements.
24 Q. Okay. Now, let's talk about the reasons
25 you might have for emergency interruptions. Could

one be due to lack of adequate generation supply?

A. I am not a transmission expert that I could answer those.

Q. I'm talking generation, I'm sorry.

A. Generation would move to the transmission service side of the business.

Q. Okay. But you are sponsoring the tariff.

A. Not what would cause an emergency interruption.

Q. Okay. But the answer is if there was an emergency interruption, if there is a need for an emergency interruption, however that's determined, whether it's caused by generation or transmission or distribution system issues, the company can call one.

A. It would be for the reliability of the system, yes.

Q. So if the company determined that a lack of generation, adequate supply would affect the reliability of the system, the company could call an

emergency interruption under the terms of the tariff you have proposed.

A. As I said before, I don't want to speak on things I don't know what would cause emergency interruptions, so I don't think I could answer that properly.

EXAMINER PRICE: Is an emergency interruption defined somewhere in the application of the tariff, to the best of your knowledge?

THE WITNESS: To the best of my knowledge, I don't know.

EXAMINER PRICE: Is there another FirstEnergy witness who might know the answers to those questions?

THE WITNESS: I'm not sure.

MR. STONE: Can I?

EXAMINER PRICE: Yeah, I'm done, thank you.

MR. STONE: Thank you.

Q. (By Mr. Stone) Could you refer to rider ELR.

A. I'm there.

Q. If you look at the version I am on, again, is Schedule 3A, page 81 of 103, original sheet 99. It says "Emergency Curtailment Event." It's

20 page 4 of 6 in the rider.

21 A. Yes.

22 Q. In here it says for purposes of the --

23 second sentence, "For purposes of this rider, an

24 Emergency Curtailment Event shall be one in which the

25 company "a reasonable -- "a regional transmission

1 organization and/or a transmission operator
2 determines, in its respective sole discretion, that
3 an emergency situation exists that may jeopardize the
4 integrity of either the distribution or transmission
5 system in the area," correct?
6 A. Yes, that's what's stated there.
7 Q. So what this would mean is that if any of
8 those three entities, the company, the RTO, or a
9 transmission operator, in their sole discretion
10 determined there was an emergency situation that
11 jeopardized the integrity of these two systems,
12 whatever their reason was, they could call an
13 emergency curtailment.
14 A. Yes.
15 Q. Okay. The fact that it could be a -- RTO
16 suggests that it could be a regional problem that
17 could call for an emergency curtailment, correct?
18 A. Based on how MISO was seeing the grid,
19 yes.

20 Q. The fact that it could be the company or

21 transmission system operator could mean it's a local

22 problem that was causing the problem -- the need for

23 an emergency curtailment, correct?

24 A. Yes.

25 Q. Okay. And whether regional or local

1 problem, if any one of these three entities deemed it
2 was necessary, they could call for an emergency
3 curtailment?
4 A. Yes, yes.
5 Q. Okay. Great.
6 Now, is there anything in here that
7 restricts the curtailments to summertime?
8 A. No, but that is normally when peak demand
9 occurs.
10 Q. Right. But, in fact, under the tariff,
11 the interruption can occur any time 24 hours a day, 7
12 days a week, 365 days a year, correct?
13 A. Yes.
14 Q. Okay. And the customer has got to stand
15 ready and be ready to curtail if and when you call?
16 A. Yes.
17 Q. Okay. And the whole point of this is to
18 help assure reliable service to all the other
19 customers.

20 A. Yes.

21 Q. And you would agree this, in essence,

22 avoids capacity costs for the company and that's why

23 you have set the credit based on your estimate of

24 capacity costs, agreed?

25 A. That is true.

Q. Okay. Would you agree with me it also avoids reserves, the reserve margin as well on this load?

A. Yes, I would agree with you.

Q. Okay. Now, one way in which this avoids capacity cost is you don't have to include the interruptible load in your -- in your capacity needs, correct?

A. Yes.

Q. So it's a planning purpose.

Does it also provide an operating reserves aspect in the sense that the fact you can cut it off on 10 minutes' notice allows you to utilize it as an operating or spinning reserve? Do you know?

A. No, I couldn't speak to that.

Q. You don't know, okay.

EXAMINER PIRIK: Counsel, could you just slow down a little bit. Sometimes you are going so

fast.

MR. STONE: I'm sorry. I was trying as best I could, yes, to stay within my -- I have got a lot to cover and I wanted to cover it and let us move on, but I will try.

EXAMINER PIRIK: You are doing well. You

are doing well.

MR. STONE: Everyone tells me I talk too fast.

EXAMINER PIRIK: That's okay. That's okay. Continue.

Q. (By Mr. Stone) Now, just to ensure that the interruptible customers actually interrupt, you have provisions in the tariff that would penalize them in the event they didn't interrupt, correct?

A. Yes.

Q. Included in there, however, is a failsafe, and the failsafe is the company can actually disconnect the customer during the interruption, if necessary, correct?

A. Yes.

Q. Okay. So it's pretty much if the company wishes to, pretty much a guarantee you can get that customer off, if you want to.

A. For the reliability of the system, yes.

Q. Yes, okay.

Now, by the way, was the power plant --

do you have 100 percent guarantee the power plant

will run?

A. I don't understand your question.

Q. Wouldn't you agree that sometimes power

1 plants, when you try to start them up, don't operate?
2 A. Yes.
3 Q. And sometimes when they are operating,
4 they stop working?
5 A. They have outages, yes.
6 Q. Okay. Now, just very briefly, the
7 penalties are pretty heavy here. I wanted to just
8 run through them.
9 EXAMINER PRICE: Mr. Lavanga, if you want
10 to turn that one off. I think that's the feedback.
11 MR. STONE: We are a technically
12 challenged group, I can say.
13 Q. All right. Let me run through quickly
14 the --
15 MR. STONE: I will get this one of these
16 days.
17 Q. Where was I?
18 In addition, the ability to disconnect
19 the customer, some of the other penalties include

20 forfeiting the credit during the month in which you

21 failed to -- this is for emergency curtailments that

22 you failed to interrupt and a 300 percent times the

23 LMP charge, correct?

24 A. Yes, that's what's listed there, yes.

25 Q. And if you are more than 110 percent over

your firm demand, the penalties escalate even further to a 12-month forfeit of credits potentially being removed from the rider, et cetera?

A. Yes.

Q. Okay. Now, I am trying to figure out what this is all worth. Have there ever been any blackouts or brownouts in Ohio?

A. I believe so, yes.

Q. Okay. Would you agree that the economic costs of a blackout or brownout can be enormous?

MR. KUTIK: Objection.

A. I have no idea.

Q. All right.

MR. KUTIK: Mr. Warvell, you have to listen. If I object, let the Bench rule. I would appreciate it.

Q. Let's go to the credit for a second. Your proposed credit for emergency interruptions is the $1.95, correct?

20 A. As stated before, yes, due to the

21 capacity numbers, yes.

22 Q. All right. And that's based on the $64

23 number that you mentioned to me earlier?

24 A. Yes.

25 Q. Okay. And basically it's converting that

$64 number into a -- to a per kW number?

A. Yes.

Q. Per month, okay.

Now, that $64 number doesn't include in it reserves, does it?

A. No, it does not. As you indicated before, we don't know what that reserve number is going to be yet.

Q. Right. But you would agree with me you do avoid reserves; you did already agree with me.

A. I did.

Q. Yeah, so it would be something more than the $64.

A. We would propose to change that, yes.

Q. And you also don't know what the actual --

MR. KUTIK: I'm sorry.

A. I'm sorry, when I said we propose that number could change, but it would be based on the

20 reserve percentage that would be approved by MISO.

21 Q. Okay. But that reserve percentage is

22 going to be somewhere between 10 and -- 10 and 20

23 percent, right?

24 A. I don't know specifically. I would say

25 that's a reasonable estimate.

Q. Right. Now, so you propose to increase the interruptible credit in the rider based on whatever that percentage is?

A. Yes.

Q. Okay. Now, does that $64 number, is that at the generator?

A. I don't understand your question "at the generator."

Q. Is that the cost for DNR at the generator?

A. Yes.

Q. Yeah. I mean, it doesn't reflect losses.

A. No.

Q. Okay. And you would agree with me for interruptible customers you actually avoid losses as well?

A. What losses are you speaking of?

Q. Line losses for getting the power from the generator to the customer.

A. Yes.

Q. Okay. Now, where did you get the DNR price that you quoted, the $64 a megawatt day?

A. As I indicated before, through a broker market confirmed it and also through a bilateral agreement that was done by FES.

Q. Okay. Do you recall when we discussed this issue in your deposition?

A. No, I do not.

Q. Do you recall mentioning anything about a broker market?

A. I --

MR. STONE: Can I approach the witness, your Honor?

MR. KUTIK: He has the deposition there.

THE WITNESS: I do not have.

MR. KUTIK: I'm sorry.

MR. STONE: Do you have a copy?

EXAMINER PIRIK: I think if you could just show him.

MR. KUTIK: I have it.

EXAMINER PIRIK: Oh, you have it.

THE WITNESS: Where are you at?

Q. (By Mr. Stone) Page 135 and line 21. And just to refresh your recollection, I asked the

20 question "How did you get the market value? Is it

21 published somewhere?"

22 And you said "We got it through a copy of

23 a bilateral agreement," correct?

24 A. Yes.

25 Q. Did you mention any other sources?

A. No, I did not.

Q. Okay. And this is a bilateral agreement that FES had with some other entity?

A. Yes.

Q. Okay. And you said that FES was purchasing it, purchasing this DNR?

A. I believe they did purchase it.

Q. Do you know when this agreement was executed?

A. No, I don't recall.

Q. Do you have any idea when the price was negotiated or determined?

A. No, I do not.

Q. Okay. I also asked you "Do you know what the price today is for capacity, DNR capacity, sold bilaterally in the marketplace?"

And you said "No"?

A. No, I don't know.

Q. Okay. And is there any published basis

20 for determining what the bilateral costs of --

21 A. There is no published market that I know

22 of.

23 Q. There is no published market, okay.

24 And this is for 2009, correct?

25 A. Yes.

Q. Would you agree with me the -- and actually with Dr. Jones as well, that the price of capacity is likely to go up once the DNR requirements are set?

A. There is a possibility for that to happen, yes.

Q. Okay. He said it was likely. I just wondered if you thought it was likely too.

A. It depends on what time frame you are looking at, so I would stick by my answer it's possible, yes.

Q. Okay. But you don't know because you haven't gone out and checked on 2010 and '11?

A. That is correct.

Q. Now, the credits that you put into rider ELR and OLR, the $1.95, is there any proposal here this is going to change over the three years or is this a fixed credit?

A. As indicated, as you talked about as far

20 as the planning reserve percentage, it would be based

21 on looking at what the market would be for '10 and

22 '11 as well. That credit would change with the

23 capacity cost change.

24 Q. So you're proposing to actually at some

25 point or another to file a rescission to the rider?

A. We would do that, yes, if capacity markets changed.

Q. So if the Commission establishes a cost in this proceeding, your proposal would be -- how often do you plan on changing it?

A. I would assume it would be done on the planning year process to match the MISO market.

Q. Is that indicated anywhere in your filing?

A. No, it is not.

Q. Okay. I mean your filing suggests that the $1.95 is set in place for the full three years, correct?

A. There's not language that specifically says either way, I believe.

Q. But you don't show a revised tariff for 2010 or 2011 for ELR and OLR, do you?

A. No, we do not.

Q. Okay. What are the expected requirements

20 for DNR resources? Do you know?

21 A. I don't know the legal aspects of what

22 the contract would hold.

23 Q. Is there -- do you know or do you expect

24 any requirement for dispatchability, in other words,

25 if the unit would be available a certain amount of

time?

In other words, notice to be able to operate, ramp up, all that sort of thing?

A. I don't know what would be involved in the contract with a bilateral agreement with a DNR.

Q. Would you agree that some of the units' FirstEnergy Solutions is planning to use DNR requirement would not be able to ramp up in 10 minutes?

MR. KUTIK: May I have the question read, please.

(Record read.)

A. I don't know all the -- all the units' capabilities, so I don't think I could answer that.

Q. Are all generating units capable of ramp-up in 10 minutes?

A. I don't know the ramping capability of all the FES units.

Q. But that's not what I asked you.

Are all types of generating units, whatever they are, capable of ramping up in 10 minutes?

A. Not being a generation expert, being a layperson, I would say that that would be unlikely.

Q. Yeah. That, you know, coal plant, a

combined cycle might take longer than 10 minutes to get going and ramp up to whatever level?

A. Like I said, I am not a generation expert. I don't know.

Q. All right. But an interruptible customer would be required to respond in 10 minutes?

A. That is the way it is written, yes.

Q. Why did you choose the 10-minute period?

A. That was already in the previous interruptible rider.

Q. Would you have a problem with making it more notice?

A. As I said before, that is what was in the previous rider.

Q. Presumably there was a good reason for it is what you are saying.

A. I believe for it to qualify for emergency as far as the MISO requirements, I believe it is 10 minutes, but not being an expert or reading the

20 tariff, I am not sure what the requirements are.

21 Q. All right. By the way, did you also

22 indicate to me in the deposition you had seen a

23 market price in PJM at some point for the western

24 zone?

25 A. I believe we did talk about that in the

1 deposition, yes.

2 Q. And I believe you said the last price you

3 had seen was around $96 a megawatt day?

4 A. For the Western Reserve for the RPM

5 process.

6 Q. Yeah.

7 A. Yes, but not -- not specifically.

8 Q. To FirstEnergy.

9 A. Yeah.

10 Q. I understand. And that was actually a

11 more published market, right?

12 A. That is an auction clearing that happens

13 in PJM.

14 Q. Okay. But there isn't a clearing auction

15 mechanism in MISO at this time?

16 A. Correct, MISO is an energy-only process.

17 Q. And would you agree with me that you've

18 done no other -- "you" meaning the companies have

19 done no other analyses or studies to calculate the

20 value of the interruptible credit other than to use

21 this DNR price?

22 A. Yes, as we talked about earlier, the

23 value is the capacity value for the interruption, so

24 that is what we are using as the DNR price.

25 Q. But you have done no other study or

analysis what the value ought to be other than this calculation of the $1.95, correct?

A. That is what we feel the value of the capacity value would be that would be required to fulfill that requirement, yes.

Q. I understand that but just answer my question.

You have done no other study or analysis what the capacity value ought to be other than the $64 number and converting it into $1.95, correct?

MR. KUTIK: Objection, mischaracterizes his testimony.

EXAMINER PIRIK: I'll allow the witness to answer the question.

A. I guess I'm not understanding.

Other than that is the value of capacity, that's all we've --

Q. That's all you've done.

A. Yes.

Q. All right. All right.

Let's talk for a moment about how you calculate the demand for -- the realizable curtailable load for purposes of applying the interruptible credit, okay?

A. Okay.

Q. Now, in calculating the demand for the interruptible credit realizable curtailable load, you don't propose to use the peak demand; is that correct?

A. That is correct. We looked at the peak demand and the peak demand compared to the coincident peak for the months does not match up for all of our interruptible customers.

Q. Okay. So -- so let's stop you there for a second.

In the case of the -- in the case of the transmission situation, even though transmission costs were caused by coincident peaks, you chose to bill the customer based on their noncoincident-peak demand, correct?

A. Yes.

Q. So even though it didn't match up, that was acceptable for you for purposes of consistency, correct?

20 A. For consistency, yes.

21 Q. And you told me the same thing related to

22 the, what was it, rider CCA, correct?

23 A. Correct.

24 Q. And anything else that was measured based

25 on demand where you were charging the customers you

said for consistency, you should bill it based on the customer's peak demand whenever it occurred, correct?

A. Yes.

Q. Even though it didn't coincide or match up with their coincident peaks, right?

A. That is true.

Q. And even though the costs were caused by coincident peaks, correct?

THE WITNESS: Could you read that back again, I'm sorry.

(Record read.)

A. Yes.

Q. Okay. In this case you say it doesn't match up perfectly either, but in this case you are not using consistency; you are actually getting a different measurement for peak demand to apply the interruptible credit, correct?

A. Yes. As I stated before, the interruptible customers do not match up with the

20 peak, and we are required with MISO to be able to

21 give them an accurate number of what would be

22 required in an emergency situation, so we are using

23 reli -- re -- I have a hard time with that one --

24 realizable curtailable load.

25 Q. Now, whatever number you choose to give

to MISO does it -- doesn't control what you do in this tariff, does it?

You said you are required by MISO to give them an accurate amount of interruptible load.

A. Correct.

Q. I think isn't it really true what you are required to do is give them an accurate -- you are going to project for them firm load which you are going to exclude all interruptible load from, correct?

A. Yes.

Q. Yeah. So now -- and whatever you give to MISO doesn't drive how you -- how you charge the interruptible customers, does it?

Let me try it this way. You testified earlier that the fact that you paid MISO or others based on transmission based on one basis didn't stop you from collecting it from customers based on another basis.

Wouldn't the same be true here? However you calculate it for MISO, aren't you still allowed to collect it from customers in whatever way you want to?

A. I wouldn't say "whatever way you want to" but -- could you repeat that question just one more

time?

Q. Okay. What you said is that even though you are required to pay for transmission based on coincident peak.

A. Okay.

Q. For other reasons and consistency it was appropriate to charge customers based on something other that coincident peak.

What I am saying, if that's true in that case, wouldn't it also be true in this case that despite the fact -- whatever you are required to do for MISO in terms of the interruptible load, can't you recover the costs based on peak demand from interruptible customers to be consistent the same way based on peak demand? You don't know --

A. You can base it on peak demand, yes.

Q. I'm sorry, I didn't mean to interrupt.

MR. STONE: Did you get his? All right. Thank you.

20 Q. Now, just a couple quick questions about

21 how you do the RCL, just so we know.

22 It is a -- the way you propose to do it

23 is rather than measuring the peak demand each month

24 you measure it from the previous year, correct?

25 A. From accurate data, yes.

Q. Yeah, but it's accurate data from demand from the previous year.

A. Yes, based on historical, yes.

Q. So based on -- and, in fact, it's hours of 12 to 6 on nonholiday weekdays during the months of June through August, correct?

A. That is correct.

Q. With taking out emergency interruptions or economic interruptions if it improves the number?

A. Working out the calculation both ways, whichever one is --

Q. Greater.

A. -- greater, that is the one we use.

Q. Yeah. So, again, that would be based on -- so in this case if this tariff takes affect on June -- or January 1, 2009, the demands, whatever they are, have already been set in 2008, correct?

A. Correct.

Q. Okay. And would you agree that the June

20 through August period is probably -- the periods you

21 have identified are probably the highest cost periods

22 in the marketplace highest cost energy prices, June

23 through August, nonholiday weekdays, 12 to 6?

24 A. It would be the peak time for load during

25 at least in our control area.

Q. Right. Don't you think it's also likely to be the highest times for energy costs in the MISO market LMPs?

A. I would have to study that data, but it's the peak time frame within our control area.

Q. Right. Peak tends to imply higher prices, all things being equal, right?

A. Correct.

Q. Now, in fact, wouldn't many of these hours likely be subject to economic buy-throughs anyway, economic interruptions if they are on peak times?

A. As we said, we calculate the percentage with and without that interruption.

Q. I understand that. But wouldn't it be likely a lot of these hours would be economic interruptions?

A. Without looking at the data, I don't have an answer for that.

Q. Okay. Now, would you agree with me this is about roughly 380 hours a year, the 12 to 6, nonholiday weekdays, et cetera?

A. I have to put pencil to paper on that.

Q. Well, it would basically be six hours times however many days that are weekdays during the

1 month times three months, right?

2 A. Yes, like I said, but without putting

3 pencil to paper, I couldn't agree with your number.

4 Q. Okay. But it's a fairly small -- you

5 would agree with me on order of magnitude it's a

6 small percentage of the hours of the year?

7 A. Compared to the entire year, it's

8 significantly less, yes.

9 Q. Is it possible that actual demands may be

10 significantly higher or significantly lower than the

11 demands from the previous year?

12 A. Demands could change from year to year.

13 Q. Yeah. Either a customer's load grows or

14 it declines.

15 A. Yes.

16 Q. Okay. Now, if you call for an

17 interruption, is the customer allowed to just

18 interrupt its realizable curtailable load, or does it

19 have to interrupt all of his had all the way to the

20 firm?

21 A. Interrupt all the way to the firm.

22 Q. And if a customer's load is not at peak

23 level when you call it, is a customer allowed to go

24 on and let it grow up as soon as it's still

25 interruptible, the piece that's realizable

curtailment, or does it have to stay at its firm demand?

MR. KUTIK: May I have that question reread.

MR. STONE: Let me rephrase it, it's easier.

Q. If the customer is at or below its peak demand -- strike that.

If the customer's load is not even -- strike that too.

Whatever demand the customer has at the given time the company calls for a curtailment, it has to lower its demand down to the firm peak demand, and it cannot go above that, correct, down to the firm demand -- excuse me, it can't go above that?

A. It means to lower it to its firm load, yes.

Q. And if it's below the firm, it can't go below -- above the firm once you call the

20 curtailment?

21 A. Yes, that is true.

22 Q. Okay. Now, let's talk briefly about

23 the -- how the interruptible program fits for demand

24 response.

25 Would you -- first, would you agree that

the companies have had interruptible programs in place for many years, right?

A. Yes, to my knowledge, yes.

Q. Yeah. And would you agree that after the passage of the new law that there are demand response goals the company has to meet?

MR. KUTIK: Are we talking about SB-221?

MR. STONE: Yes.

THE WITNESS: Could you read that question back one more time.

(Record read.)

A. Yes.

Q. And do you believe interruptible load would be helpful in meeting those?

A. That's one fashion that things -- that that could help with, yes.

Q. If you lost interruptible load on the system, would that be a negative in terms of demand response?

20 A. Without replacing -- without some other

21 feature?

22 Q. Yes, okay. Do you know how much

23 interruptible load there is on FirstEnergy's system?

24 A. I believe it's around, based on history,

25 about 350 megawatts.

Q. Okay. Do you know if you've lost any interruptible load in the last few years?

A. I haven't looked at the data to know that answer.

Q. Do you know if you gained any?

A. Don't know.

Q. Okay. Have you done any analysis or study to determine whether existing customers will utilize either one of the two proposed interruptible rates that you have offered?

A. I know we've talked to some customers, but I don't know if we've surveyed or interviewed all of them, no.

Q. Okay. Would you agree in general that if a customer is to take a program like interruptible, they have to assess the overall requirements and decide if it would work for them and if it will provide benefits to them?

A. Yes. It would be a customer's decision.

Q. Okay. And so basically, customer acceptance has some -- plays a role in designing an interruptible rate.

A. Yes.

Q. And have you done any analysis of whether there are any customers out there that might sign up

for rider OLR?

A. I'm not aware of that, no.

Q. Okay. Let's talk -- let's move on to economic interruptions for just a moment.

Now, first, would you -- given that you set the credit of $1.95 for ELR and OLR at the same level, would you expect to be removing economic interruptions from rider ELR?

A. I am not understanding your question.

Q. I am just curious if you would object -- if you would object to removing ELR -- you said ELR has both economic interruptions and emergency interruptions, correct?

A. Yes.

Q. OLR just has emergency interruptions, correct?

A. Yes.

Q. They both have the same credit, correct?

A. No. I disagree with that.

Q. They both have a $1.95 credit.

A. As part of this rider, but ELR also has a $6.05 credit that is part of the economic development rider for those interruptible customers.

Q. Do you think that credit relates in some fashion to whether they are economic interruptions?

A. Yes.

Q. Okay. Would you have a problem with moving that credit over to rider ELR then and out of the economic development rider if it -- if it really relates to the value of economic interruptions of the rider?

A. That is not the way we have proposed it, no.

Q. So you wouldn't agree to do that, at least not at this point?

A. No.

Q. Okay. All right. Let's talk about the trigger for economic interruption in the ELR.

It's a -- correct me if I am wrong, but it's when your LMP -- the MISO LMP for the FirstEnergy control area is above the otherwise applicable kilowatt-hour net charges as set forth in the companies' rider, the GEN and GPI riders?

THE WITNESS: Could you read that back,

please.

(Record read.)

A. Yes.

Q. Now, this is the day ahead LMP as defined in the tariff that you are talking about when you talk about the LMP for three hours, three consecutive

1 hours?

2 A. Yes.

3 Q. So since you are using the day ahead

4 prices, won't you know a day ahead whether you need

5 an economic interruption?

6 A. Yes.

7 Q. So why not give more than 90 minutes'

8 notice?

9 A. Because we won't know until the time

10 that -- it's needed for the basis of determining if

11 an emergency is needed.

12 Q. Let me try it a different way.

13 Would you agree with me on the

14 emergency -- emergency curtailments you only require

15 10 minutes' notice?

16 A. Yes.

17 Q. So the customer has to cut off in 10

18 minutes for an emergency.

19 A. Yes.

20 Q. And would you agree with me for economic

21 interruptions under rider ELR you commit to giving 90

22 minutes notice?

23 A. We've committed to give 90 minutes'

24 notice, but we do forecast the day ahead the

25 possibility of an interruption as far as an economic

interruption is concerned. That's forecasted ahead of time for those customers.

Q. But the reality is if you are using the MISO LMPs, you are going to know a day ahead what the prices are going to be, correct?

A. Yes.

Q. So I guess my question was instead of 90 minutes' notice, why not commit to give it a day ahead?

A. That is not what we have proposed.

Q. I understand. All right.

Let me explore with you just a minute and make sure I understand what the "otherwise applicable per kilowatt net charges set forth in the tariff riders" would actually be.

You know, let's take your -- let's take a simple example where the customer is not on a time-of-use rate.

Are you basically saying you take the GEN

20 charge for that customer during that hour or during

21 that season, subtract from it the GPI credit, and

22 that's the per kilowatt hour charge that you use as a

23 target?

24 A. I'm sorry, where are you at? What you

25 are reading?

Q. I'm not. You had agreed with me a minute ago that it comes from the tariff. I could find it in the tariff, if you would like.

Hold on one second. Okay.

If you are -- if you have got rider ELR there, Schedule -- Sheet 99, page 4 of 6. It's Schedule 3A, page 81.

A. Okay.

Q. At the bottom down there under "Economic Buy-Through Option Event," are you there?

A. No. I don't have that sheet that you are referencing.

Q. Do you have the Economic Load Response Program Rider?

A. Yes. And I am --

Q. Page 4 of 6.

A. Okay. Got you.

Q. At the bottom it has paragraph E, "Economic Buy-Through Option Event"?

20 A. I am there.

21 Q. I'm sorry, this is the section that

22 governs economic curtailments?

23 A. Yes.

24 Q. And it's where it provides for the

25 90-minute notice we just talked about?

A. Yes.

Q. Okay. And then it says in the second sentence it defines a market premium condition where you are allowed to call for an economic interruption, correct?

A. Yes.

Q. Okay. And that says it "exceeds the otherwise applicable per kilowatt-hour net charges set forth" in rider GEN and generation phase-in riders?

A. Yes.

Q. Okay. Now, would you agree with me -- first, I want to figure out how you get to the otherwise applicable per kilowatt-hour net charges.

I assume what that means is you take the generation charge applicable to that particular season and subtract from it the GPI credit and that's the number you are using as the target.

A. Yes.

20 Q. Okay. What happens if you are on a

21 time-of-use rate, do you use the time-of-use

22 generation minus the time-of-use generation phase-in

23 credit?

24 A. Yes, you would.

25 Q. So it would be a different target for

1 different customers, correct?

2 A. Yes.

3 Q. Okay. Now, this would apply summer and

4 winter, correct?

5 A. Yes.

6 Q. So, for example, you could be

7 interrupting customers in the winter at a price for

8 economic curtailment at a price significantly below

9 the price you couldn't interrupt them in the summer,

10 correct?

11 A. The price would be different. I don't

12 know the significance or the delta between them.

13 Q. Right. But we could look at your

14 generation rider and let's say -- if you want to look

15 at it, we can.

16 Let's say, for example, you would agree

17 with me with the seasonal rate differential that your

18 rate is lower in the winter than it is in the summer.

19 A. Yes.

20 Q. So it's possible you could have three

21 hours where LMP in the winter is higher than the

22 seasonal winter price but below the target for the

23 summer -- below the rate for the summer, excuse me.

24 A. That could happen, yes.

25 Q. And when that happens, would you -- you

1 would call an interruption under the tariff.

2 A. Based on --

3 Q. This.

4 A. -- the information that we just

5 discussed, yes.

6 Q. Yeah. That's how it's proposed anyway.

7 A. Yes.

8 Q. Okay. Do you recall that in the -- do

9 you recall that in the competitive bidding proposal

10 that you made last year that you proposed a target of

11 125 percent of the LMP instead of 100 percent?

12 A. The proposal -- which proposal are you

13 talking about? The 2007 auction proposal?

14 Q. Yes, for interruptible. You proposed

15 interruptible with 125 percent as the target instead

16 of 100 percent. Do you recall?

17 A. I am not specifically but I believe that

18 was in the filing, yes.

19 Q. Okay. Do you know why you chose

20 100 percent instead of 125 percent here?

21 A. The 125 percent was based on different

22 criteria as far as the interruptible load is and the

23 credit that is produced during the EDR process as

24 compared to the filing that is in this proposal.

25 Q. Well, there was no credit proposed in the

1 2007 cases, was there, in your filing?

2 A. It would be calculated based on the price

3 that would occur through MRO process.

4 Q. That's your recollection at least of the

5 CBP, correct? I mean are you stating a fact that

6 they were going to calculate an interruptible rate

7 through MRO solicitation? In the 2007 CPB case?

8 A. I'm not understanding the question, I'm

9 sorry.

10 Q. I guess I am not understanding your

11 answer of the earlier. Let me try again.

12 You mentioned that the percentage had

13 something to do with the credit that was going to be

14 calculated through the MRO process. Are you telling

15 me that the credit in the 2007 case was going to be

16 calculated through the MRO solicitation?

17 A. I'm telling you part of the calculation

18 of the interruptible credit would have been

19 calculated based on the auction clearing price that

20 would possibly have occurred at that '07 case that

21 you are quoting.

22 Q. Do you know if your current tariffs use

23 the three times -- or three consecutive hours LMP

24 above the existing generation price as the target?

25 A. I do not believe the current tariffs

state that. It is a policy that has been developed in -- over the time period for the interruptible load.

Q. So you think that right now you don't curtail under the current tariffs unless -- unless it's three times -- unless there is three consecutive hours the LMP is above the generation price in the tariff?

A. No, that's not what I said.

Q. What do you do now?

MR. KUTIK: Had you finished your answer?

MR. STONE: I'm sorry.

THE WITNESS: Could we go back to the question. I'm sorry, I gotten thrown off.

EXAMINER PIRIK: Yes.

(Record read.)

A. I don't know the specific policy at this time.

Q. Okay. Thank you.

Now, would you -- well, let's talk about -- I think we talked about some of them but let's make sure we are on the same page of the conclusion.

Economic interruptions allow much more advanced notice than emergency interruptions,

correct?

A. Yes.

Q. Okay. With economic interruptions you have a right to buy through, correct?

A. Yes.

Q. Which means you don't have to curtail, you can buy through just at a higher market price, correct?

A. Yes.

Q. Okay. It's -- in fact, the economic interruption is essentially an agreement to take the risk of market price power for certain hours of the year in exchange for an advanced payment, correct?

THE WITNESS: Reread that question for me, please.

(Record read.)

A. When you say "an advanced payment," you mean a credit for the customer.

Q. That's what I mean, per kWH over the

period.

A. A credit for the customer, yes.

Q. And would you agree that whether a customer should -- I think you said you were a controller in a previous life, correct?

A. In a previous life, yes.

Q. And if you were working for a company that was going to take service on an uninterruptible tariff, would you agree that whether or not you would want to take that would depend on whether the expected credit you were going to get from it was going to exceed your buy-through cost?

A. I don't know how people would balance those two risk factors, but I would assume they wouldn't look at both sides -- both sides of that coin, yes.

Q. And wouldn't you expect that you would impute some risk -- some additional risk factor that the price -- the price might be higher -- let me back up.

A customer, in signing up for this, doesn't really know, nor do you, for that matter, what the actual buy through prices are going to be, do they?

A. No.

20 Q. No. And so they have to -- so in effect

21 what they are doing is hedging for you, customers

22 are.

23 A. I believe they are hedging for themselves

24 but.

25 Q. Well, if they take the risk of market

prices --

A. They are also getting the credit, as we talked about earlier.

Q. They are getting a credit, okay.

But they are also hedging for you, for FirstEnergy, because FirstEnergy won't have to supply the energy during those -- it will supply the energy but only at the market prices, which will be the above the prices in the tariff, correct?

A. That was really fast.

Q. Let me try it again.

This is also hedging for FirstEnergy, correct?

A. It's signing up for a reduced capacity, yes.

Q. Okay. So for FirstEnergy during the hours in which they have an economic interruption arrangement with a customer, FirstEnergy does not have to supply the energy at its rate in its tariff

20 but can supply it at the market price, correct?

21 THE WITNESS: Reread that, please.

22 (Record read.)

23 A. No. It work based on the customer buying

24 through.

25 Q. Well, if the customer doesn't buy

1 through, let's take the two instances, option one,
2 you have an economic interruption, the customer
3 doesn't buy through. FirstEnergy avoids having to
4 sell the energy at its tariff rate when the market
5 prices are higher, correct?
6 A. It avoids the obligation to serve that
7 customer that load.
8 Q. During those hours.
9 A. Yes.
10 Q. And by avoiding the obligation to serve
11 the customer during those hours, it is -- it frees up
12 that energy to sell it in the market at a higher
13 market price, correct?
14 A. No.
15 Q. What happens to the energy?
16 A. There is no energy.
17 Q. Can you explain?
18 A. Explain what?
19 Q. You say "there is no energy." Why is

there no energy?

A. We are not serving a customer.

Q. So the energy you would have had to serve the customer if they would have been a firm customer, where does that energy go when they get -- where does it go if they become an economic interruption

1 customer?

2 A. I'm confused by your question. Can you

3 restate?

4 Q. All right. During an hour of

5 interruption, economic interruption -- if the

6 customer signs up as a firm customer, FirstEnergy and

7 therefore FES is required to supply energy during

8 every hour of the day, correct?

9 A. Yes.

10 Q. Okay. If the customer agrees to be -- if

11 the customer agrees to be economically interruptible,

12 then FirstEnergy avoids having to serve that customer

13 during hours in which the energy price would be above

14 its tariff price, the energy price in the market

15 would be above for three consecutive hours of its

16 tariff price, correct?

17 A. Yes.

18 Q. Okay. So FirstEnergy or FirstEnergy

19 Solutions, somebody is saving the difference between

20 the -- for an economic interruptible customer

21 FirstEnergy is saving or avoiding the difference

22 between the tariff price and the buy through price,

23 correct?

24 A. Yes.

25 Q. Okay. Now, by the way, who is saving

that? Is that -- is that coming from the operating company -- does the operating company get that benefit or does FirstEnergy Solutions get that benefit?

A. It would depend on who has that obligation.

Q. And who does, under your proposal who would have the obligation to provide the energy?

A. Until that was struck between FES and the operating companies, I don't know that answer.

Q. All right. Has there been any reconciliation mechanism proposed to take the buy through payments and give them back in some fashion to the customers?

A. Reconciliation mechanism to do?

Q. Put a different way, you said before -- let me make sure I understood.

You said before that the benefit of that avoided cost is either going to go to the company --

20 to the operating companies or FirstEnergy Solutions.

21 There is no proposal to give that to the customers as

22 a credit, correct?

23 A. That is true.

24 Q. Okay. Wouldn't you expect that that cost

25 avoidable under the economic interruptions -- never

1 mind. Strike that.

2 We were talking about the differences

3 between economic interruptions and capacity -- or

4 emergency interruptions.

5 Would you agree with me that because of

6 those -- that because of those differences there are

7 different products basically willingness to

8 economically interrupt versus willingness to

9 emergency interrupt?

10 A. They could be considered different

11 products, yes.

12 Q. Okay. Is it possible or even likely at

13 least some customers could respond to 10 minutes

14 notice -- strike that. Some customers could respond

15 to 90 minutes or more of an economic interruption,

16 particularly when they can buy through, that might

17 not be able to respond to a 10-minute notice

18 emergency curtailment?

19 A. I don't know that answer.

20 Q. Well, put it this way, would you agree

21 there are customers who can't respond to a 10-minute

22 notice emergency interruption?

23 A. I don't know.

24 Q. Okay. How many hours of economic

25 interruption are customers likely to face under the

criteria in this rider?

A. I don't know.

Q. Does the company have any study or analysis that tells us how many?

A. No.

Q. No estimate?

A. As I stated before, I don't know the forward price by hour any more than anybody else.

Q. So but when we don't know prices, sometimes we forecast them, we look at history, that sort of thing, and I just want to know has FirstEnergy done any analysis whatsoever how many economic interruptions a customer might face?

A. For 2009, no.

Q. Or 2010 or 2011?

A. No.

Q. Okay. All right. Let's switch gears for a minute and talk about capacity requirements.

MR. STONE: If I could have this marked

as Nucor Exhibit No. 1.

EXAMINER PIRIK: The document will be so marked.

(EXHIBIT MARKED FOR IDENTIFICATION.)

Q. I will give you one minute to familiarize yourself with this.

All right. Mr. Warvell, is this Nucor Exhibit No. 1, is it the companies' response to Nucor Request No. 1-6?

A. Yes, it looks to be.

MR. STONE: Okay. Company willing to stipulate this is the full, complete, correct copy?

MR. KUTIK: The witness can testify to what it is.

MR. STONE: I'm sorry.

Q. Mr. Warvell, would you agree this is a full and complete copy of your response? I will make representation to you I believe it is but.

A. Yes.

Q. Okay. Now, I have a couple of questions about this.

First, you explain in subsection B -- on the second page of this document proposed revisions to Module E of the MidWest MISO tariff, correct?

A. Yes.

20 Q. In explaining that, tell me if I have the

21 gist of this right. The gist of this is if you

22 don't -- if your capacity deficiency as proposed --

23 if your capacity is deficient, the penalty is $80,000

24 per megawatt month, correct?

25 A. That's what the proposal is, yes.

Q. And that's about $80 per kW month, correct, divided by a thousand?

A. Yes.

Q. Okay. And so that's the proposed penalty in the event you don't meet your capacity requirements?

A. Under the module E that MISO is proposing.

Q. Yes.

A. Yes.

Q. Do you have any idea what the basis for this $80,000 per meg --

A. No.

Q. -- how they calculated --

A. I don't know.

Q. You don't know how they calculated it?

A. No, I do not.

Q. Now, turning to page 3 of this document, you have a list of generating units that FirstEnergy

20 proposes to make available to serve the FirstEnergy

21 retail load in this case, correct?

22 A. Yes.

23 Q. All right. And it's over 11,000

24 megawatts of capacity, correct?

25 A. Yes.

Q. Do you have any idea what the total installed -- or net costs, installed costs, any figures about the cost of this capacity?

A. No.

Q. No. But you agree that nonetheless but you agree it's most likely billions of dollars of cost?

A. I have no idea.

Q. No idea. Are there nuclear units in here?

A. I believe so. That would be Perry, yes.

Q. Coal units?

A. Yes.

Q. Combined cycle?

A. Yes, I believe there are.

Q. And combustion turbines?

A. Yes.

Q. Okay. Now, would you agree with me that FirstEnergy will want to recover the fixed costs --

20 FirstEnergy Solutions, excuse me, would want to

21 recover the fixed costs associated with these units

22 in the rates that it charges the operating companies?

23 A. Like I said, I'm not part of the

24 negotiations of what FES would want as far as

25 negotiations between them and the operating

1 companies.

2 Q. I know that, but you've told us a number

3 of places in the plan you've assumed what they would

4 want, you know, they want this proposal or that

5 proposal, and I guess my question is would you assume

6 under that same kind of approach they would want to

7 recover the fixed costs associated with these units

8 if they are going to make these units available under

9 this contract?

10 A. I guess I'm not following the assumptions

11 that FirstEnergy and the operating companies would

12 reach an agreement that would be similar to the

13 application.

14 Q. Right. If you assume that is what you've

15 said that you would assume, if you assume that, do

16 you assume that FirstEnergy is going to want to

17 recover the fixed costs associated with these units,

18 FirstEnergy Solutions?

19 A. I'm still -- I don't know how they are

20 going to justify working through the application in

21 coming to an agreement between FirstEnergy Solutions

22 and the operating companies.

23 Q. Don't you testify that your proposal here

24 recovers the capacity costs associated with this

25 transaction?

A. I wouldn't say that it -- like before, we have not built up cost structures to recover costs in this application.

Q. But don't you -- didn't you say that the rate that you have proposed here recovers the capacity costs associated with these plans? You don't -- does it or doesn't it?

A. I'm not understanding your question.

Q. Does the rate you have proposed here for generation recover the capacity costs associated with the plans that you say FirstEnergy is going to make available to the customers?

A. I believe I said that our generation rate was going to be below market rate -- proposed market rate option and that part of that process would involve the units of FES.

Q. And if these units would be made available -- put it this way, as a businessman, is FES going -- would anybody sell power where they

20 didn't recover the fixed costs of their generating

21 units over the three-year period designating these

22 units to meet this load, et cetera?

23 A. I would assume so, yes.

24 Q. You would assume they would want to

25 recover them.

A. Yeah.

Q. Okay. Now, but follow up what you just said to me a minute ago, FirstEnergy didn't prepare a standard cost of service study in this case, correct?

A. No, it did not.

Q. Okay. And you don't have any idea what the capacity -- you said you didn't have an idea what the overall cost was. I presume you can't tell me what the capacity cost per kW for this capacity is either.

A. No, I cannot.

Q. Okay. Would you agree with me that FirstEnergy Solutions incurs the -- has to cover this capacity cost in some fashion regardless of what the load factor is of the system, regardless of how much energy is sold?

A. Being an unregulated entity, they would basically get market price for the cost of capacity.

Q. Well, actually they get whatever price

20 you negotiate with them, correct? If the Commission

21 approves the ESP, they get the price that's in the

22 ESP.

23 A. They would get the price that would be

24 related to the generation price of the agreement.

25 Q. Right. My question is, though, doesn't

1 FirstEnergy Solutions incur the same fixed costs or
2 same capacity costs regardless of how many kilowatt
3 hours they actually sell?
4 A. Yes.
5 Q. Okay. And -- well, let me ask this, do
6 you know what the expected installed costs of the
7 Fremont plant is, the plant you talked about?
8 A. No, I do not.
9 Q. Is that a combined cycle?
10 A. I believe so.
11 Q. When is it supposed to be installed by?
12 A. January 1, 2010.
13 Q. Would you agree with me that
14 FirstEnergy's rate for generation and transmission
15 historically vary -- per kilowatt-hour rate
16 historically varied among customer classes in --
17 MR. KUTIK: Objection. When you say
18 "FirstEnergy," who are you talking about?
19 EXAMINER PIRIK: Could you please

20 clarify?

21 MR. STONE: The operating companies but I

22 will ask it again.

23 Q. Would you agree with me FirstEnergy

24 operating companies' rates for generation and

25 transmission in their retail tariffs on a

per-kilowatt basis varied among customer classes?

A. Yes.

Q. And typically the higher load factor customer classes had lower -- had a lower responsibility per kilowatt hour for these costs?

A. I don't know the exact numbers so.

Q. You don't know?

A. I don't know.

Q. Okay. Would you expect a supplier in the competitive market to change the -- charge the same price per kilowatt hour per customer with a 40-percent load factor as to a customer with an 80-percent load factor?

A. As we talked before, it would depend on the situation for that customer as far as their ability to shop and other risk factors that would be involved.

Q. I mean, a supplier, if the -- if the customer went into the competitive market instead of

20 staying on FirstEnergy, and it had -- and it was a

21 20-percent load factor customer, and the next

22 customer otherwise same usage characterization had an

23 80-percent load factor and both of them went to a

24 competitive supplier to get retail supply in a

25 competitive market, would you expect the one with

1 20-percent load factor to pay more per kilowatt hour
2 than the one with 80-percent load factor?
3 A. From a wholesale --
4 Q. From a retail perspective.
5 A. From a retail perspective, as I indicated
6 before when we looked at Dr. Jones's exhibit as far
7 as his load factor analysis --
8 Q. No --
9 MR. KUTIK: Let him finish his answer.
10 THE WITNESS: I'm sorry, could you -- I'm
11 sorry. Could repeat what I had just started to say.
12 (Record read.)
13 A. That looking at the load factors that --
14 on an energy wholesale basis that high load factor
15 customers were less expensive to serve, but when you
16 take into consideration other risks that would occur
17 as far as shopping and for industrial customers, that
18 that possibly may not be true as an overall retail
19 price.

20 Q. What I was trying to ask you -- let me

21 see if I can get -- a customer, as I said, leaves

22 FirstEnergy and goes and shops in the retail market,

23 okay, not the wholesale retail market, and they go to

24 buy power from Retail Supplier A, and there's two of

25 them, one of them has a 20-percent load factor and

the other has an 80-percent load factor, otherwise their usage -- same peak demand, you know, the time of use characteristics are the same.

Would you expect the customer that had a 20-percent load factor to have a higher per kilowatt hour charge than the customer who has an 80-percent load factor?

A. As I said before, it would depend on the contract which would be struck between the CRES supplier and that customer, and I wouldn't assume unless you've seen what the contract was that was going to happen.

Q. Would it be rational to charge on a per-kilowatt basis for a competitive supplier to charge more for the lower load customer?

A. I think I just answered that.

Q. So your answer is?

A. I don't know what would transpire between the CRES supplier and the customer.

20 Q. Let's take a simple example with the

21 company that -- if a supplier is going to supply a

22 customer and that supplier has a certain amount of

23 fixed costs associated with their generating

24 capacity, would you agree? Any supplier to serve any

25 customer would have fixed costs associated with their

generating capacity, correct?

A. No. As we stated, there is a market out there so they could buy it from a wholesale market.

Q. Well, then the wholesale supplier would have a -- the ultimate supplier of the electricity, the ultimate generator would have -- let's try it differently. Let's talk about FirstEnergy Solutions.

You agreed with me there would be fixed costs associated with the supply that FirstEnergy Solutions would want to recover.

If the load, the total company load, were at a 10-percent load factor, they would be able to recover those fixed costs over -- on a per-kilowatt hour basis over kilowatt hours equal to 10 percent of the hours in the month, correct?

A. We have done no cost-of-service study so I have not been involved in one so I don't know the answer to your question yes or no.

Q. All right. Let's try -- let me try it

one more way and maybe we can get there, maybe we can't.

Assume hypothetically a customer has a thousand -- a supplier has $1,000 of fixed costs that they need to recover from a -- from a customer or a set of customers, okay?

A. Okay.

Q. $1,000 of fixed costs. If -- let's take the first scenario. The first scenario you have a customer who has a 10-percent load factor. That means they are going to use 73-kilowatt hours a month for every kW of demand, right?

A. Yes, based on your assumption, yes.

Q. Yeah. And similarly if the customer has a 20-percent load factor, that means they are going to use 146-kilowatt hours a month for every kW of demand, correct?

A. Okay.

Q. So in the first case, if the -- using the hypothetical, if the supplier wants to recover the $1,00 of fixed costs from Customer A, the one with the 73-kilowatt hours, they would have to recover it -- they would have to recover it on a per kilowatt-hour basis 1,000 divided by 73, right?

A. Yes.

20 Q. Okay. And in the second scenario,

21 Customer B, they would have to recover -- because it

22 used 146-kilowatt hours per kW as a higher load

23 factor, they would have to recover on a per-kilowatt

24 hour basis $1,000 divided by 146, correct?

25 A. Yes. In that example, yes.

Q. In that example the charge for the first customer at 10-percent load factor per kilowatt hour to recover those fixed costs would be twice what the charge per kilowatt hour would be for the second customer, correct?

A. Yes.

Q. Okay. Now, let's talk about, you know, also the type-of-use pattern. If all the -- you would agree with me on-peak prices are generally higher than off-peak prices, correct?

A. In general, yes.

Q. And, in fact, you have proposed time-of-use rates that reflect that, correct?

A. They would be similar, yes.

Q. So if a customer -- if a customer or group of customers only used power off peak, by definition the cost to serve that customer would be lower than if they used power both on peak and off peak, correct?

20 A. If they are on a time-of-use rate.

21 Q. Even if they weren't on a time-of-use

22 rate, let's talk about the cost of serving them

23 first.

24 Let's take a simple example. We have a

25 class of customers and that class of cus -- and

for -- well, class of customers and they only use off peak. Would you agree that their rate would be lower -- excuse me, their cost, their cost to serve them, would be lower than if a customer class only used on peak?

A. From the wholesale market perspective?

Q. Yes.

A. Their costs would be lower based on their time of use, yes.

Q. Okay. So time of use character -- never mind. Strike that.

And, similarly, their costs would be lower than a class that used some on and some off. The class that only used off peak would be a lower cost than the class that used some on peak and some off peak, correct?

A. Yes.

Q. Okay.

MR. STONE: Your Honor, I don't know how

you do this, should I offer this exhibit now or am I allowed?

EXAMINER PIRIK: I will do all the exhibits at the conclusion of the witness.

MR. STONE: Okay.

EXAMINER PIRIK: How much more cross do

you have?

MR. STONE: 30 minutes.

EXAMINER PIRIK: Well, I want -- for the witness -- we are off the record, right?

(Discussion off the record.)

(Recess taken.)

EXAMINER PIRIK: Go back on the record.

Mr. Stone.

MR. STONE: Yes.

Q. (By Mr. Stone) Just to clarify one thing on the discussion we were having previously, Mr. Warvell, you -- is it fair to say that the company hasn't calculated the capacity costs that FirstEnergy Solutions might have to provide services under this tariff?

A. Calculated the capacity value of its units, FirstEnergy Solutions?

Q. Yeah.

A. There has been no calculation.

20 Q. Okay. Now, I believe you testified with
21 some other folks there presently is in place a
22 wholesale contract with FirstEnergy Solutions to
23 supply the energy to the operating companies for
24 service today.
25 A. Yes, there is a PSA agreement, yes.

Q. Okay. And prior to that agreement, which I believe is a three-year agreement, would you agree it's a three-year agreement for the three-year period? Would you agree it was a three-year agreement?

A. I haven't read the agreement but I believe so.

Q. And would you agree there was an agreement in place with FirstEnergy Solutions prior to that one to provide service?

A. Beyond my knowledge.

Q. You don't know. I'm sorry, you don't know?

A. I don't know.

Q. Okay. Would you agree with me in the current agreement that the same units that you are proposing in -- to supply service under the new agreement would be -- strike that.

Let me say that a different way.

Would you agree that the same units that are supplying service currently for FirstEnergy Solutions to FirstEnergy will also supply service under the new arrangement that you are proposing in your ESP?

A. There are no differences in units, no.

Q. So the list of units we took a look at a few minutes ago, Nucor Exhibit 1, those are units that are supplying energy currently under the existing rates?

A. Yes.

Q. Okay. And there's no proposed change other than the fact you are going to add some generation in the Fremont unit?

A. I think it's Attachment S, I think there might be various --

Q. Various things will be added but at least existing units are still there and still going to provide service under this new proposal?

EXAMINER PRICE: You might want to try to switch it all the way to the other side of the notebook.

MR. STONE: You think it's the speaker.

EXAMINER PRICE: It's as good a working theory as any right now.

MR. STONE: Hypothesis, we want to test it, right?

THE WITNESS: Could you repeat that last question, read that last question back, please.

(Record read.)

Q. Let me rephrase the question for you.

The units listed on Nucor Exhibit 1, all of those units are currently owned and operated by FirstEnergy Solutions, correct?

A. Yes, except for OVEC, yes.

Q. Except for the OVEC load, yes.

And would you agree that those -- these units that -- these are the units you propose to provide service from under the ESP, correct?

A. Yes.

Q. And I think you already agreed with me, let me make sure, these are the same units that provide service under current arrangement with FirstEnergy Solutions that's in place and the service is occurring right now, correct?

A. It would be these units plus the ones that are in PJM.

Q. Okay. So are you proposing that fewer units would be available under the new ESP than were available historically?

A. No.

Q. So PJM ones are supplying PJM load today and they will continue to supply PJM load going forward and that's why they are not included in here.

A. No. They are required under the rules for capacity. They are listed as PJM capacity.

Q. Okay. So are they providing service today or -- to FirstEnergy Solutions -- FirstEnergy operating companies in Ohio or -- never mind. I think we have enough information on this.

All right. I want to talk to you briefly about development of your time-use rates.

A. Okay.

Q. I believe the workpaper that you referred me to in the deposition, let me refer you there, is Schedule 5A, page 7 of 7.

A. Yes.

Q. Okay. And if we can really quickly walk through to make sure we understand how you developed time-of-use rates in this docket. Basically in the -- the first column lists the time-of-use periods, correct?

A. Yes.

Q. Second column lists the number of hours that occur in those periods, correct?

A. Yes.

Q. Third column lists the just adding up LMPs for each of those hours, correct?

A. Yes.

Q. So it's an arithmetic, just add each one up.

The fourth is the -- fourth column is the average price based on dividing the amount in column 3 by the amount in column 2.

A. Yes.

Q. Okay. Yeah. And then the fifth column is the development of a factor to basically apply these time-of-use cost differentials to the generation rate that you have proposed in this case in order to determine optional -- in order to determine seasonal rates and time-of-use rates, correct?

A. Correct.

Q. Okay. Now, other than the use of a -- well, you use the factor down here of the 74.88 divided by 75, and that was basically an adjustment factor as you noted to reflect the difference between the 2006-2007 period and the period the rates are going to take effect, correct?

A. Yes.

20 Q. And that factor is applied to all of

21 these -- factors utilized in all of the factors in

22 the fifth column?

23 A. It is a multiple, yes.

24 Q. Yes. Now, would it be fair to say that

25 if a customer -- based on the way you have done this,

if a customer uses the same amount of energy each hour of the day 365 days a year, they would -- they would pay exactly -- exclusive of this adjustment, they would pay exactly the price that's the generation price that you proposed?

A. Less the phase-in, yes.

Q. Yes, okay. And the same is true with time-of-use rates; if they use exactly the same number of kilowatt hours every hour, then the time-of-use rate would produce exactly, again, the generation rate minus the phase-in you proposed?

A. Yes, that is approximate.

Q. Okay. Now, of course, the customers aren't required to use exactly the -- exactly the same number of kilowatt hours every hour, are they?

A. No.

Q. And to the degree their kilowatt hours differ, that could result in -- that would result in the company making either -- or generating either

20 less or more than the generation costs per kilowatt

21 hour?

22 A. Yes.

23 Q. Okay. Now, is there any -- have you

24 proposed any reconciliation mechanism to deal with

25 either the seasonal differential or time-of-use

1 differential?

2 A. No. We have proposed no reconciliation

3 mechanism for rider GEN.

4 Q. Right. So in the event that customers

5 use more -- in the event based on customers -- total

6 customer usage across your system ends up, as I think

7 you said, could end up with either a price that is --

8 or a total -- total generation costs that's higher

9 than the 7-1/2 cents or lower than the 7-1/2 cents,

10 correct?

11 A. I didn't say that but you did and I

12 agree.

13 Q. I'm sorry. And so -- and so -- whatever

14 it is though, you don't propose the customers take

15 responsibility for it; either FirstEnergy Solutions

16 or FirstEnergy the operating companies will take

17 responsibility for it?

18 A. We will take that risk.

19 Q. Right.

20 A. Either way, yes.

21 Q. And it isn't -- I presume your answer is

22 the same, that hasn't been decided to take that risk?

23 A. You are correct.

24 Q. Yes. Okay. Now, if you wanted -- if the

25 Commission wanted to or if some party wanted to

1 develop different on-peak or off-peak periods, they
2 could do it with the same methodology that you have
3 utilized here, they would just have to take the
4 average -- the number of hours, the average LMP
5 during those hours, and follow the same math, and you
6 could develop a different set of on-peak and off-peak
7 periods, if you want to, correct?
8 A. Define -- you would have to define them,
9 yes.
10 Q. Yes. But, for example, if you defined an
11 on-peak hour of 6 hours a day instead of what you
12 were 16, I think?
13 A. Yes.
14 Q. Six hours a day, then the way you do it
15 if you were doing it, you would use exactly the same
16 methodology, you would just simply define the six
17 hours, define the average -- add up the LMPs for
18 those hours, go through the same process we just went
19 through, and develop a rate differential for that

20 period? One could do that?

21 A. One could do that, yes.

22 Q. And if one were trying to develop a

23 different set of periods, would that be a reasonable

24 methodology for actually calculating the rate

25 differential?

A. It would be a reasonable methodology depending on how you were going to bill the customers and the customers' ability to track that time of use.

Q. So would you agree with me the company could have -- no. Never mind.

That's enough. All right.

Rather than time-of-use rates like -- or in addition to time-of-use rates like this could the company offer an option where you just pass through the LMPs themselves?

A. We have not made that proposal.

Q. Do you see any reason why -- since that is the actual energy costs in the market, do you see any reason why you couldn't?

A. As we talked about earlier in regards to our standby charge, the wholesale price and the retail price are different. You would have to mark up that wholesale price to match the retail price in which you were going to give the customer.

20 Q. Even if you excluded it from FirstEnergy

21 Solutions' obligation to serve, you simply bought it,

22 mark it, and just pass it through, why would you mark

23 up that generation cost?

24 A. As we talked about in the standby charge,

25 you would have to mark up the wholesale product to

match the retail product that you would be delivering to the customer.

Q. Because of?

A. Because of the added costs in regards to wholesale compared to retail.

Q. In the case where FirstEnergy, the operating companies, separated out this load and bought it on an LMP basis from the MISO market, what would be the additional costs?

A. The additional costs of moving the LMP -- moving that basis from the wholesale LMP market to the retail product, as we talked about before as far as capacity was concerned and also as far as renewable energy credits, that would be needed as well as the movement of basis.

And as stated before in Dr. Graves' testimony and also Mr. Johnson's testimony is that that differential ranges at least 40 percent if not -- in Mr. Graves' testimony between 40 and

20 80 percent on a market basis.

21 Q. All right. Let's -- only a couple of

22 things left here.

23 One, you had a discussion -- a couple of

24 discussions yesterday with various counsel about this

25 issue of items that -- how this -- your proposal here

the ESP relates to MRO. And you identified -- you had a discussion about a number of areas in that.

You talk about a different aspect of that. In ESP as we have discussed you proposed a time-of-use rate, correct?

A. Yes, they are.

Q. You did not propose time of use in the MRO, correct?

A. No, we did not.

Q. And the MRO I am referring to is the one that was filed concurrently with ESP, so we are referring to the same thing. Are we okay on that?

A. 936, I think it is.

Q. Yeah, 08-936-EL-SSO.

And similarly you didn't propose -- you propose a generation phase-in or deferral, whatever term you want to use in this case, for the ESP, correct?

A. Yes.

Q. And you didn't propose one for the MRO.

A. No. They are two separate filings.

Q. Okay. I am just trying to understand the differences in comparing the MRO and the ESP, and you propose interruptible rates in the ESP, correct?

A. Yes.

Q. And did not in the MRO, correct?

A. No, we did not.

Q. Okay. And you propose an economic development rate rider provision in the ESP, correct?

A. Yes. The ESP has different requirements than an MRO process has.

Q. Okay.

A. So the designs don't -- do not necessarily have to be the same.

Q. Okay. But you didn't propose it in the MRO, the economic development rider or any form of it.

A. Not testifying on that part of the MRO, I wouldn't qualify that to be true, no.

Q. You don't know or you think that you did file it in EDR?

A. I believe the interrupt -- or the economic development rider could be done in either an MRO process or an ESP process.

Q. Okay.

EXAMINER PRICE: Excuse me. I thought the question was did you propose it, not whether it could be done.

THE WITNESS: There is a development rider that is in the MRO. And like I said, I didn't

1 testify to it, but I believe it was around the CEI
2 contracts.
3 EXAMINER PRICE: Okay.
4 THE WITNESS: And other contracts that
5 could arise in an MRO process.
6 EXAMINER PRICE: Thank you.
7 Q. (By Mr. Stone) Let me ask you this to
8 clarify that then, the ED -- whatever you filed in it
9 for economic development rider or whatever it was in
10 the MRO, it wasn't the same in the ESP, correct? You
11 don't know?
12 A. Like -- I would have to read both of them
13 and match them up. I just know that as I just stated
14 before, that there is an economic development portion
15 in the MRO as there is in the ESP.
16 Q. Would you agree with me the various
17 things that I've listed, leaving aside the economic
18 development rider for a minute because of your
19 answer, the other things I have listed are options

20 that would be beneficial to customers?

21 A. There are two separate filings, and as

22 far as an MRO process is concerned, the idea would be

23 that customers would have a definite choice of

24 shopping as well as in this process if there was

25 things that would not be relevant that a customer

seeked and there was other things that they needed to help their business or them personally, they could go out and shop for that requirement.

Q. All -- but my question was do you think that -- would you agree that these things that you are offering, time-of-use rates, time-of-day rates -- excuse me, interruptible rates, in your opinion generation deferral, the other issues we discussed, are beneficial to the customer and options customers might want?

A. They are options for customers. I don't know if I would classify them as benefits. I would just classify them as options for customers.

Q. Okay. And you mentioned about the definite choice of shopping under the MRO. Aren't the customers supposed to have the definite choice of shopping under the ESP as well?

A. I believe in my answer I stated that they have that option in both cases.

20 Q. Okay. So you think that they viewed that

21 option -- I'm sorry. I understand what you said.

22 Since the contract between FES and the

23 operating companies is not in place at this point,

24 you said you are not involved in the negotiations,

25 whatever changes the Commission might want to make to

1 this -- your ESP, the operating companies could then
2 go to -- go to FirstEnergy Solutions and attempt to
3 negotiate those arrangements, correct?
4 THE WITNESS: Can you repeat that
5 question, I'm sorry.
6 (Record read.)
7 A. I think, first, between the Commission
8 and the operating companies how the ESP plan would be
9 adjusted would be determined first, and then
10 depending on that I believe that would have to be
11 addressed during those negotiations, yes.
12 Q. Thank you. And can the operating
13 companies commit for FirstEnergy Solutions in this
14 case?
15 A. As far as commitment?
16 Q. As far as commit them to do the deal,
17 commit them to sign -- have the operating companies
18 been given the authority to -- to commit to the
19 Commission that FirstEnergy Solutions will sign a

contract?

A. As I stated before, I'm not part of any negotiations and all I can say is that based on the Application, it would be assumed that the -- a contract would be struck between the operating companies and FES.

Q. But you can't commit -- are you able today or are the operating companies today through this Application committing FirstEnergy Solutions to sign a contract with the provisions that are in this ESP?

MR. KUTIK: Objection. There is no foundation this witness has authority to speak about what FirstEnergy can do vis-a-vis the FES.

EXAMINER PIRIK: Overruled.

THE WITNESS: I'm sorry, repeat the question.

(Record read.)

A. I am today speaking that based on the Application, my assumption is that a power sales agreement could be worked out between the operating companies and FES, and that's my understanding today.

Q. But are you commit -- are you able -- he didn't answer my question, I don't think. Are you able to commit --

20 A. I am not personally able to commit.

21 Q. Okay. Let me make sure, the reason I

22 ask, on page 4 of your testimony, line 6, if you

23 refer to it, just want to make sure we are on the

24 same page, it says "As part of the generation supply

25 and pricing proposal, the Companies have committed to

1 fixed generation prices," and then you go on.
2 Now, you define "companies" earlier on as
3 the operating companies -- you know, I am just trying
4 to find out what "committed" really means.
5 Are the companies committing to this even
6 if -- I think you explained yesterday the companies
7 weren't committing to this if FES didn't sign the
8 contract.
9 So I am trying to find out are you
10 committing on behalf of FES, and I think you are
11 telling me you are not; is that correct? You can't
12 make a commitment on behalf of FES they will provide
13 the power under these terms and conditions?
14 MR. KUTIK: Objection, that
15 mischaracterizes his testimony.
16 EXAMINER PIRIK: I will overrule the
17 objection and allow the witness just to explain
18 exactly what is meant by "commitment."
19 THE WITNESS: My commitment is based

20 again on my knowledge that a contract could be struck

21 between the operating companies and FES.

22 Q. So is FES committed to this deal then?

23 A. I cannot commit FES to any contract.

24 Q. Do you think the Application commits FES

25 to the contract?

A. As I said, it's assumed in my testimony that a deal could be struck between the operating companies and FES.

Q. But it doesn't commit.

A. Legally --

Q. Yeah.

A. -- commit them?

I don't believe so, not being an attorney.

Q. Okay.

A. I can't make that statement.

Q. All right. Do you know if there is any agreement in place with FES for short-term ESP?

A. Again, I don't -- do not know.

MR. STONE: Okay. I just have I think one other area. Can I mark for identification Nucor Exhibit No. 2?

EXAMINER PIRIK: The document shall be so marked.

(EXHIBIT MARKED FOR IDENTIFICATION.)

MR. LAVANGA: May I approach the witness?

EXAMINER PIRIK: Yes.

Q. Do you have that, Mr. Warvell?

A. Yes, I do.

Q. Okay. And is this a -- is this

1 companies' response that was sponsored by you to
2 Nucor question 1-8?
3 A. Yes.
4 Q. Is the answer true and correct to the
5 best of your knowledge?
6 A. Yes.
7 MR. STONE: Thank you. That's all I
8 have. Thank you.
9 EXAMINER PIRIK: Thank you. I almost
10 forgot staff.
11 Mr. Jones.
12 MR. JONES: Thank you.
13 - - -
14 CROSS-EXAMINATION
15 By Mr. Jones:
16 Q. Good afternoon, Mr. Warvell. My name is
17 John Jones, I represent the Staff in this proceeding.
18 A. Good afternoon.
19 Q. Mr. Warvell, I don't have -- surprisingly

20 I have some questions left after all that, but first

21 of all, you would agree, would you not, that there

22 are many terms and conditions in FirstEnergy's ESP

23 plan, correct?

24 A. There are a number of riders, yes.

25 Q. Okay. And also included in the plan are

1 deferrals and future recovery of deferrals; is that
2 correct, for generation --
3 A. The one I am sponsoring, yes.
4 Q. -- deferrals? And you helped, I guess,
5 generate Attachment A; is that correct? You cite
6 that in your testimony?
7 A. Along with others, yes.
8 Q. Okay. And Attachment A is the document
9 that breaks down the base generation charges and the
10 carrying costs for deferring generation phase-in? It
11 provides all that information; is that correct?
12 A. Yes. As far as my involvement it was
13 basically the first page of information on the
14 phase-in.
15 Once we get to the options and the
16 deferrals, that is more in the lines of Mr. Wagner
17 as -- and I believe as far as the security at this
18 stage, that's covered by Mr. Blank, if that helps.
19 Q. Did you participate in discussions with

20 those other people you just described for the

21 carrying costs for these phase-in charges, generation

22 charges?

23 A. I did not, no.

24 Q. Are you aware of what the calculations

25 would show doing the time value of money on these

1 calculations as to what future value of this money --
2 in terms of costs would be for this plan?
3 A. I did not, no.
4 Q. So, Mr. Warvell, looking at this plan in
5 the aggregate, you really don't have -- speaking for
6 yourself, you don't have an idea of what we are
7 talking about in terms of what the overall charges
8 would be to customers, FirstEnergy customers; is that
9 correct? Is that fair to say?
10 In terms of compare -- in comparing the
11 ESP plan-MRO option looking at it in the aggregate?
12 A. I believe that's covered by Dave Blank's
13 testimony as far as what the net present value of the
14 calculation would be.
15 Q. A lot of the riders have pass-through
16 costs, correct, and we don't know what those costs
17 could show over the term of the plan; is that a
18 correct statement?
19 A. When you say -- the riders do have some

20 cost provisions depending on load and costs in the

21 future, yes.

22 Q. Okay. And so there would be adjustments

23 going to those riders over the course of the plan,

24 the three-year plan; is that correct?

25 A. They could kick into effect as far as

1 increasing costs or not be recognized at all
2 depending on the factors just mentioned as far as
3 load or cost.
4 Q. So when we talk about the base fixed
5 generation cost here in your plan, the 75, 80, 85
6 over those three years for megawatt hours of power
7 here, I mean, that's just it, it's just the base; is
8 that correct?
9 A. It would be that less the phase-in if a
10 customer was involved, yes.
11 Q. Right, but there is a lot of -- all the
12 costs that would be then added onto that base for
13 your overall plan; isn't that correct?
14 A. Those costs would only materialize, as we
15 said before, based on load and also possible cost
16 increases.
17 So the ESP plan does have that, but the
18 comparison as far as an MRO process would occur, you
19 would assume from my perspective that if costs were

20 the driver, those costs would be related to market

21 prices, thus the MRO price would increase, and

22 there's no guarantee in our MRO process filing for a

23 fixed price charge for a customer for those

24 comparisons to be -- to be made.

25 Q. But you are trying to make comparisons in

your testimony, are you not, because you took the time to analyze Dr. Jones' and Graves' testimony on the market rate retail price option in comparison to the FirstEnergy ESP plan?

Did you not make a comparison analyzing that testimony as part of your testimony?

A. Based on the information provided, and as I indicated, our ESP would be better than the forecasted numbers from Drs. Jones and Graves, yes.

Q. So you are recommending the Commission to adopt the FirstEnergy's ESP plan over the market rate option; is that your testimony?

A. Yes.

Q. How can you -- how can you make that recommendation when you don't know all the costs involved with the ESP plan?

A. Just as I stated before, based on the assumption that if increased costs were going to occur in the process, that that would also increase

20 the MRO process.

21 So for a comparison of what we proposed

22 here compared to what Drs. Jones and Graves have put

23 in their testimony, I believe the ESP plan would be

24 better than MRO.

25 Q. And you are stating that in terms of the

aggregate of looking at what the interest rate is going to be for carrying those charges for the phase-in over those 10 years and also those riders that have -- are going to be adjusted during that time frame of the term of the three-year term?

MR. KUTIK: Objection. As the witness has said, those are calculations made and discussed in Mr. Blank's testimony.

MR. JONES: Your Honor, he is making a -- recommending that the ESP plan is better in the aggregate than MRO, but yet he doesn't know what the costs are going to be for the ESP to make a comparison.

EXAMINER PIRIK: Objection overruled.

Do you want the question reread?

THE WITNESS: Please.

(Record read.)

A. Yes, based on the net present value calculation that I reviewed from Dave Blank's

20 testimony, I still say the ESP plan would be better

21 than an MRO process.

22 Q. But isn't it true, Mr. Warvell, that you

23 don't have all the information to make that

24 recommendation?

25 A. I don't know what information I am

missing.

Q. The information you just talked about as to what, you know, what that interest is going to be, how it accumulates over that deferred period of time, and the rise over 10 years, and also what those riders are going to show in terms of costs. You said you don't know.

MR. KUTIK: That mischaracterizes his testimony, your Honor. I object.

EXAMINER PIRIK: Could you rephrase the question, Mr. Jones?

MR. JONES: Yes, thank you.

Q. My question is, Mr. Warvell, that you don't have sufficient information to make a recommendation comparing the MRO to the ESP because the very fact is you didn't do those calculations on running out those numbers on 10 years for the phase-in of the generation part and also those riders that are going to be adjusted over that period of

time of the plan; is that correct?

MR. KUTIK: Objection. That's argumentative. The witness has already indicated Mr. Blank made those calculations. He insinuates because he hasn't made the calculation, he can't know.

MR. JONES: Your Honor, you can't have it that way. You can't say I have a recommendation because I know all the information. And in the second breath he doesn't have enough information to talk about what the costs are for the adjustable riders and what the interest rate is going to be on the 10 years that you are going to defer the carrying costs for the phase-in generation.

EXAMINER PIRIK: Objection overruled.

Do you want the question reread?

THE WITNESS: Yes.

(Record read.)

A. I personally did not perform the analysis that is in Dave Blank's testimony, but I believe the numbers for the deferral is part of that analysis as well as the differential of the market prices that were proposed in Dr. Jones' and Dr. Graves' testimony as a net present value calculation.

Q. (By Mr. Jones) So you know what those

20 numbers are from Mr. Blank's testimony for the

21 carrying charges for the deferrals?

22 A. I'm sorry, I don't understand your

23 question.

24 Q. You said that you have made yourself --

25 you have done something with Mr. Blank's testimony.

1 You know what he says.

2 A. I reviewed it.

3 Q. You reviewed it. So what are the numbers

4 that show for the carrying costs over those 10 years

5 for the phase-in?

6 A. I don't know exactly.

7 MR. JONES: I have no other questions,

8 your Honor.

9 EXAMINER PIRIK: Thank you.

10 MR. KUTIK: May I have a few minutes,

11 your Honor?

12 EXAMINER PIRIK: We will just take 5

13 minutes, unless you need more than that.

14 MR. KUTIK: I would appreciate a little

15 bit more than that. We had two and a half hours of

16 cross-examination this morning, I would like a little

17 more time.

18 EXAMINER PIRIK: Let's go off the record

19 for a minute.

(Discussion off the record.)

(Recess taken.)

EXAMINER PIRIK: We will go back on the record.

Mr. Kutik.

MR. KUTIK: Thank you, your Honor.

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REDIRECT EXAMINATION

By Mr. Kutik:

Q. Mr. Warvell, you were asked some questions about where in the Application it discusses what would happen if there were problems or issues relating to a contract between FirstEnergy operating companies and FirstEnergy Solutions. You pointed to one paragraph. Are there any other paragraphs in the Application that address that?

A. Yes. I believe if you look in the Application, what I was trying to get to yesterday was on page 35 at the top of the page, letter J, that paragraph, "to the extent it's necessary, the terms and conditions of the plan will be embedded in the wholesale power sales agreement between the companies and FES, which agreement will contain wholesale pricing and necessary arrangements and will require FERC approval or a general affiliate waiver. The

20 plan is conditioned upon all necessary FERC approvals

21 of the agreement between FES and the companies to

22 carry out the terms and conditions of the matters set

23 forth herein."

24 Q. You were asked some questions about the

25 FCA rider, the FTE rider, and specifically questions

about whether it was possible that FirstEnergy Solutions could somehow manipulate their invoices to throw only the largest or the biggest sums into the next -- to be recovered through that rider. Is that likely?

A. All the invoices would be included in the rider.

Q. You were also asked questions about whether -- if the -- if it's unknown at this point exactly what sums might be attempted to be recovered through the rider, why the Commission would have any determination to believe that that's reasonable.

Will the Commission have an opportunity to review the costs that are proposed to be recovered through those riders?

A. Yes. The Commission would review all the costs similar to the process that's in the fuel deferrals today.

Q. You were also asked questions about --

EXAMINER PRICE: Excuse me, can I have that question and answer back again, please.

(Record read.)

EXAMINER PRICE: Thank you very much.

Q. You were also asked questions about environmental costs and the potential for FirstEnergy

1 Solutions to have to put scrubbers on equipment and
2 things like that.
3 If new regulations came in as recently as
4 later this year, would it be likely that the -- that
5 the -- that FirstEnergy Solutions would be able to
6 spend any kind of significant sums on capital
7 projects of the sort to respond to those regulations
8 within the term of the ESP?
9 A. No, I don't believe so, and also those
10 would be under Commission review as well as far as
11 the costs would be concerned.
12 Q. Why don't you believe that FirstEnergy
13 Solutions would be spending money on such projects
14 within the three-year period?
15 A. Such a large project, the large project
16 that you mentioned, would take engineering design,
17 and basically the amount of equipment and process
18 needed, it would take longer than a three-year
19 period.

20 Q. Let me refer you to your testimony, page
21 11, line 11. In reviewing the transcript from
22 yesterday it appeared that you or either Mr. Stinson,
23 I believe, may have misstated and you are confusing
24 the words "unanticipated" and "anticipated," so I
25 want to ask you this question.

This sentence deals with what would happen if fewer customers shop than anticipated. Could you explain what you mean when -- in terms of what would happen under the scenario?

A. From the perspective if the company forecasted shopping to occur and that shopping did not occur, the companies or FES, depending on the obligation, would have a POLR requirement to serve those customers and, thus, that would be a risk that would be anticipated as part of the MDS charge.

Q. You were also asked questions yesterday about doing a calculation where you took a 1 cent per kilowatt hour proposed MDS charge and multiplying it by 6 -- 600 million megawatts, correct?

A. I believe it was.

Q. 60 million megawatts, excuse me.

A. Yes.

Q. To come up with a $600 million figure. Do you remember that?

A. Yes.

Q. Do you believe that that is an accurate reflection of what would be generated by the MDS surcharge?

A. No. I think it would be dependent upon shopping so for that number to occur, every customer

would have to shop.

Q. You were also asked some questions about what returning customers would have to pay. If a returning customer did not pay the standby charge on returning, would they pay rider GEN?

A. No.

Q. Would they pay the other generation-related riders?

A. Yes.

Q. You were asked some questions this morning about the PJM DNR price of $96. Do you remember that?

A. PJM RPM capacity charge, yes.

Q. Okay. And is that relevant to looking at potential charges in ESP here?

A. From a capacity perspective our operating companies sit in MISO so, no.

Q. Finally, there was a suggestion made by counsel with respect to a change in the reason -- the

20 calculation of the realizable curtailable load of the

21 ELR or the OLR using billing demand as opposed to

22 what the company has proposed.

23 If -- if the company were to follow the

24 suggestion made by counsel, would the company propose

25 any other changes to the ELR or OLR riders?

A. The rate would have to decrease to match the billing demand.

Q. And when you say "the rate," what are you referring to?

A. The $1.95 would go down, I believe, to about a little -- about $1.09.

MR. KUTIK: No further questions, your Honor.

EXAMINER PIRIK: Thank you.

OCC?

MS. ROBERTS: I don't have any questions. Thank you.

MS. WUNG: No questions.

EXAMINER PIRIK: Mr. Rinebolt.

MR. RINEBOLT: No redirect.

EXAMINER PIRIK: Ms. McAlister.

MS. McALISTER: Just a couple, thank you, your Honor.

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RECROSS-EXAMINATION

By Ms. McAlister:

Q. Mr. Warvell, I believe you just said the Commission would review all rider costs through the same process that the deferrals are currently reviewed today; is that correct?

A. Yes.

Q. Does that also apply to the transmission and ancillary service rider?

A. Yes. They review it today.

Q. Could you point me to where that is in the plan?

A. It is not in the plan. You asked that yesterday.

Q. It's been a long day.

A. Sorry. Things stick with me.

Q. And you just said that you didn't think that capital environmental projects are likely during the plan period, right?

A. No, that's not what I said.

Q. I'm sorry. Could you explain what it was you just described about the capital environmental projects?

A. I believe it was a hypothetical question in regards to major capital projects and them getting

20 built in the three-year period.

21 Q. And it was your response that it is

22 unlikely that that would happen?

23 A. Due to the design and need for that to

24 happen, yes.

25 Q. Okay. If it's unlikely for that to

1 happen, then why is the rider necessary?

2 A. It is not based on capital projects.

3 It's based on new environmental regulations that

4 could occur, taxes that we don't know about at this

5 point in time, as we talked about yesterday, a

6 possibility of new CARA rules, things of that nature.

7 EXAMINER PRICE: Would you object if the

8 Commission excluded capital costs from that

9 calculation then?

10 THE WITNESS: That is not what we have

11 proposed.

12 EXAMINER PRICE: That's not what I asked.

13 THE WITNESS: Let me hear the question

14 just one more time.

15 EXAMINER PRICE: Would you object if the

16 Commission modified your proposal to exclude all

17 capital costs from the environmental costs that could

18 be included in rider FTE?

19 THE WITNESS: I would say we would

20 object. As we just talked about, it would depend on

21 Commission approval for that to go through as far as

22 costs were concerned, and I believe we would want to

23 see what was considered a major project first, what

24 type of new environmental rules apply.

25 EXAMINER PRICE: Thank you.

MS. McALISTER: Thank you, your Honor, I have no further questions.

Thank you, Mr. Warvell.

EXAMINER PIRIK: Mr. Smith.

MR. SMITH: Yes.

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RECROSS-EXAMINATION

By Mr. Smith:

Q. You referred to -- excuse me a minute. On page 35 of the ESP plan that you read language from subpart J; is that true?

EXAMINER PIRIK: I believe it was page 37. Was it page 37? Was it 35?

THE WITNESS: 35, 35J, yes.

Q. Now, are you sponsoring this language?

A. The Application is being sponsored, I believe, by Dave Blank.

Q. Do you have personal knowledge whether this statement is even true?

20 A. It's proposed in our Application.

21 Q. That's the extent of your knowledge?

22 A. That's the extent of my knowledge.

23 Q. And throughout your testimony you

24 disclaim any information about the status of the

25 negotiations between FES and the operating companies;

is that true?

A. I am not involved in any, that is true.

Q. And you would agree that even though it's stated in ESP Application that unless FirstEnergy Solutions agrees to that language, it would not be implemented?

THE WITNESS: Could you read that back, please.

(Record read.)

MR. KUTIK: Objection. I am not sure what "that language" refers to.

MR. SMITH: Language on J, page 35.

MR. KUTIK: Your question, FirstEnergy Solutions, do they agree to the language in J?

MR. SMITH: My question is, "Is it not true FirstEnergy Solutions would have to agree to that language for it to be implemented?"

EXAMINER PIRIK: You mean the specific paragraph J?

MR. SMITH: Yes.

MR. KUTIK: And the "it" is what?

MR. SMITH: The terms and conditions of ESP into the wholesale sales agreement.

THE WITNESS: Not being an attorney, and you are talking about language, I can just give what

I've talked about the last couple of days of my knowledge of how the contract would be worked out between the operating companies and FES.

Q. (By Mr. Smith) Okay. Moving on to another area, you testified on redirect about the operating companies recovering costs through riders under the ESP plan; is that correct?

A. I don't specifically understand your question.

Q. I will get more specific.

You testified that all costs recovered through the riders under the ESP plan would be subject to Commission review; is that correct?

A. Yes.

Q. And you related the recovery of those costs to the deferrals that have undergone Commission review; is that correct?

A. Yes.

Q. Do you not see a distinction between

20 recovering costs through the riders that are not

21 deferred versus the FirstEnergy companies deferring

22 costs for future recovery?

23 A. I was relating that they are reviewed by

24 the Commision, as far as the ability for the

25 Commission for approval.

Q. The deferrals.

A. No, in both aspects.

Q. What mechanism would the Commission use to review these costs?

A. I would assume they would audit them.

Q. The Commission staff would audit them?

A. That would be my assumption, yes.

Q. And you think the Commission staff would then have -- make a recommendation that costs deemed unreasonable should be refunded to customers?

A. I don't know what they would -- how they would do that.

Q. Does the plan provide for Commission staff review of all costs recovered under the plan?

A. I don't believe it's specifically stated in the Application, no.

Q. On the MDS I believe your testimony went to the purpose of, you can correct me if I am wrong, to basically say the amounts that were discussed

20 yesterday would be probably not the result of the MDS

21 rider being implemented. It would be less; is that

22 true?

23 A. I'm sorry, I am not following your

24 question.

25 Q. Okay. On MDS there were kWH usage

numbers, 60 million; is that correct?

A. MDS is required to hedge 60 million-megawatt hours of POLR load.

Q. And what's the significance of whether or not shopping is included or excluded from the analysis of the MDS?

A. The MDS is only charged to the shopping customer.

Q. But the reciprocal is charged to nonshopping customers, isn't it? Reciprocal, isn't there embedded in the generation rate a POLR charge for -- to cover your hedging?

A. There -- the 1 cent is in as part of rider GEN, yes.

Q. So the operating companies are whole. They are going to get the money from either shopping customers through the MDS or nonshopping customers through the GEN rate; is that true?

A. The rider GEN has 1 cent that's related

to shopping in the base G rate. The MDS charge is 1 cent that will be charged to shopping customers.

MR. SMITH: I have nothing further.

EXAMINER PIRIK: Mr. Petricoff.

MR. PETRICOFF: Thank you, your Honor.

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RECROSS-EXAMINATION

By Mr. Petricoff:

Q. Just to follow up on that point maybe to funnel it down, if you were following just the revenue that was going to the MDS charges, it would still be 600 million if there is 600 million-kilowatt hours.

Some of it, if you are shopping, is just the penny that's embedded in the GEN rate cost and -- I'm sorry. If you are an SSO customer and if you are shopping, then it's your MDS, but the -- but all together the revenue stream is $600 million?

A. And I guess specifically to the rider it would be based on the shopping customers. For nonshopping customers the utilities will be -- will receive the generation rate, yes.

Q. So -- okay. That's fine. Let's talk a little bit about the -- about the FTE rider.

Will all of the generating capacity

that's owned by FES be used exclusively or -- I'm sorry, let me start again.

Will all the generating capacity owned by FES go to the three Ohio operating companies?

THE WITNESS: Could you read that question back to me one more time, I'm sorry.

(Record read.)

A. Yes.

Q. So there will be no instance where any FES generating facility will be selling kilowatt hours to a customer other than a standard service offer customer of Ohio Edison, Toledo Edison, or Cleveland Electric illuminating?

A. I don't know. As far as energy sales; is that what your question is?

Q. Energy sales, that's correct.

A. I don't know FES's forecast for wholesale sales.

Q. But it's certainly possible that FES is going to make generation sales to someone other than a standard service offer customer of the three operating -- Ohio operating companies?

A. Yes.

Q. So let's just take power plant A that's owned by FES and ship it -- a shipment of coal comes

20 into that plant and generation is made and some of it

21 goes to SSO customers and some of it goes to non-SSO

22 customers. How will the FTE trans -- fuel

23 transportation charges be allocated in that instance?

24 A. Number one, the proposal is that the

25 operating companies have a threshold of $30 million.

Q. Okay.

A. So --

Q. I'm sorry.

MR. KUTIK: Let him finish, please.

A. First, the threshold would have to be met that the surcharges are only $30 million. All the surcharges that would be related to all the facilities would be processed through that process, not split up in a hypothetical that you have by operating company -- or, I'm sorry, by wholesale and retail.

Q. Well, let's take that portion that's over the 30 million. So that you would look at all of these transportation charges over 30 million.

At that point aren't you going to have to allocate out what went to SSO customers and what went to sales in other customers in order so the SSO customers are not to be paying more than their fair share of the -- of the transportation -- fuel

20 transportation charges?

21 A. As the rider indicates, that's part of

22 the risk and part of the threshold in which the

23 operating companies are absorbing in this process is

24 the $30 million charge. There's not a proportionment

25 after the $30 million charge.

Q. Okay. So if the -- if the -- let's say in my instance here the railroad charge is $50 million, $30 million is -- is deducted.

We now have -- we now have $20 million left. All that's going to be invoiced then to the Ohio customers, even if the Ohio customers didn't use all the power that came out of that power plant?

A. Due to the fact I don't think you can cover megawatts from one plant -- from one to another, your example is that the FTE charge would be $20 million.

Q. Do you expect that the environmental and the transportation charges in the FTE rider are going to be de minimis?

A. I don't have an expectation at this point.

Q. I am not asking you why, I just want -- I am just asking a yes or no question.

Was -- did the company have the

20 opportunity to make a projection of what the FTE

21 costs would be during the ESP period as part of their

22 application?

23 A. Is there any way you could rephrase

24 that --

25 Q. Sure.

A. -- a little bit?

Q. Sure. You'll agree with me that there is no cost projections of what the FTE -- if -- let me start over.

You will agree with me that in the Application there is no projection or estimate of how much customers are going to be charged under the FTE rider.

A. Correct.

Q. Okay. Could the company have made such a projection?

A. It would have been speculative. I don't know.

Q. You don't know whether they could have made a projection?

A. I don't know what they have based it on.

Q. So that being the case then, I guess you have to testify that these charges could be more than de minimis?

MR. KUTIK: Objection. He said he didn't know.

EXAMINER PIRIK: Objection overruled.

A. Yeah. I don't know.

Q. So it's possible these charges could be very significant?

A. I don't know.

Q. But you do know that the risk of these charges which would be very significant are now going to rest with the customers.

A. The thresholds which have been set by the company are risks the company is accepting. Above that would be risks that would be rested on the customers.

EXAMINER PRICE: Can you explain why those thresholds decline over time?

THE WITNESS: As indicated, depending on where market price is and getting to a market-based structure, those costs would be involved in a market rate offer that could occur after the three-year period.

EXAMINER PRICE: I don't think that was responsive to what I asked.

Can you explain why within the Application those thresholds decline over time from

30 million to 20 million to 10 million?

THE WITNESS: It was the risk that the company was willing to accept.

EXAMINER PRICE: So over time the company was willing to accept less and less risk?

THE WITNESS: Yes.

EXAMINER PRICE: Thank you.

Q. (By Mr. Petricoff) Does the Commission have better information than the company to appraise the risk of the FTE rider?

A. I don't know.

Q. But you will agree that you are now giving the Commission the -- you are asking the Commission to take that risk in the name of the customers and allow the customers to bear that risk?

A. That's what we have proposed, yes.

MR. PETRICOFF: I have no further questions.

EXAMINER PIRIK: Thank you.

NOPEC?

MR. BREITSCHWERDT: Just a few questions.

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RECROSS-EXAMINATION

By Mr. Breitschwerdt:

Q. In your response on redirect to a

20 question regarding page 11, line 11, you said that if

21 more shop -- if more shopping occurred than was

22 forecasted, do you recall making that statement?

23 A. Not specifically but.

24 Q. That's understandable.

25 What forecast are you referring to?

A. It would be based on the load forecast of the operating company load.

Q. And the companies are currently creating those forecasts?

A. They do create those forecasts.

Q. And is there a current forecast for the year 2009 in place?

A. That we've filed, we've filed a forecast, yes.

Q. Is there any expectation of shopping within that forecast?

A. There was no shopping forecasted in that forecast.

Q. So based on line 12 where you say more shopping than anticipated, is it the companies' anticipation based on that forecast there will be no shopping in the year 2009; is that correct?

THE WITNESS: Could you read that question back, please.

20 (Record read.)

21 A. No. In my testimony I was trying to

22 indicate that there were risks, if the company did

23 forecast shopping, that there would be a POLR risk

24 involved with that.

25 Q. But based on current forecast for 2009,

that risk would be zero; is that correct?

A. In relationship to this risk, yes.

MR. BREITSCHWERDT: Okay. That's all I have.

- - -

RECROSS-EXAMINATION

By Mr. Stinson:

Q. Mr. Warvell, to the same point in your testimony, page 9 -- page 11, line 11, yesterday I believe during our conversations you indicated that the -- an anticipated load you were speaking of there would not be included in the MDS; is that correct?

A. The POLR charge would be included as the MDS.

Q. And, now, you are stating that the POLR charge would be included as a POLR charge?

A. As a risk.

Q. So you also had testified earlier that the MDS was to recover the risk of leaving, correct?

20 A. Of customers leaving, yes.

21 Q. Yes. And is this capture of the

22 unanticipated load, is that a risk of leaving?

23 A. No. As I said, it's just a POLR risk

24 that it -- that either FES or the operating company

25 would be required to fill to serve all customers.

Q. So you are capturing two things then; a risk of leaving and a POLR risk associated with this unanticipated load?

A. With serving all load, yes.

MR. STINSON: Thank you. No other questions.

EXAMINER PIRIK: Mr. Kurtz.

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RECROSS-EXAMINATION

By Mr. Kurtz:

Q. Let me finish up from Judge Price and Ms. McAlister real quickly on this environmental capital issue. Do you recall that discussion?

A. Yes.

Q. Okay. Your testimony is that it's unlikely that there will be major environmental expenditures on the FES power plants in the years 2009 through 2011; is that correct?

A. My testimony was I said if hypothetically

20 that would happen, it would be very difficult for

21 them to construct a scrubber or an SCR within that

22 three-year time frame.

23 Q. Is it possible?

24 A. I don't know impossibility.

25 Q. What kind of state approval would be

needed for FES to build something on one of its power plants?

A. I don't know.

Q. There wouldn't be any, would there?

A. I don't know.

Q. Assuming there was any kind of capital addition at one of the FES power plants in the years 2009 through 2011 that had a useful life of 20 or 30 years, why would it be reasonable to recover those costs from consumers in a single year?

A. Based on our Application and my response, I would say that that would be under advisement, we would look into that.

Q. What does that mean?

A. Well, as I indicated, I believe it would depend on the capital requirement that would be needed for the plant and its useful life that you just expressed.

Q. Wouldn't FES make the decision on how to

20 comply with new environmental laws or new

21 interpretations of existing environmental laws?

22 Isn't FES the one who makes that decision?

23 A. I don't know how the law would come out.

24 Q. Well, don't they own the power plants?

25 A. They own the power plants, yes.

Q. So why -- so it would be their decision, wouldn't it?

A. Not necessarily, no.

Q. It wouldn't be the utility's decision, would it?

A. I don't know how -- what law you would be speaking of.

Q. On anything --

A. They could be directed to do something.

Q. Whether to hire a new generator or power plant or build a new scrubber, it's the decision of FES who owns the power plants, not the utilities; is that correct?

A. Yes.

Q. Okay. If you are FES and you have got a rider that says you can recover 100 percent of your capital costs in year one from Ohio consumers if you build a capital project, but if it's an expense by allowances, for example, rather than build a

20 scrubber, which -- which decision would you make if

21 you were FES?

22 Wouldn't you take the capital intensive

23 solution and get full recovery in one year?

24 A. I believe, as I stated earlier, that

25 would be based on Commission approval of looking at

the expenses.

Q. Are you saying that the State Commission would have approval authority over FES's capital expenditures?

A. No, that's not what I stated.

Q. Okay. So if they approve of this rider and FES does have capital expenditures and they bill the utilities, are you saying the Commission could reject it, reject that expense after having already approved the rider?

A. I'm saying the expenses would be under review of the Commission.

Q. So they could -- if they are reviewable, I guess the Commission could reject those expenses; is that what you are saying?

A. I'm just stating they would be reviewed by the Commision.

MR. KURTZ: Thank you, your Honor.

EXAMINER PIRIK: Thank you.

Mr. Yurick.

MR. YURICK: No questions, thank you, your Honor.

EXAMINER PIRIK: Mr. Stone.

MR. STONE: No questions.

EXAMINER PIRIK: Mr. Smith.

MR. SMITH: No questions.

EXAMINER PIRIK: Mr. Porter.

MR. PORTER: No questions, thank you, your Honor.

EXAMINER PIRIK: Mr. Bell.

MR. BELL: No questions.

EXAMINER PIRIK: Mr. Keiffer, are you covered already?

MR. KEIFFER: We didn't ask any direct questions, your Honor.

Also for clarification, Mr. Price had asked about the marking of exhibits that NOPEC put into the record as joint exhibits, and we did consent to that.

I have no questions for this witness.

EXAMINER PIRIK: Okay. I believe Mr. Jones.

MR. JONES: No questions, your Honor.

EXAMINER PIRIK: Okay. Thank you very

20 much.

21 MR. KUTIK: Your Honor, at this time we

22 move for the admission of Company Exhibit 5. I would

23 also advise the Bench with respect to Company Exhibit

24 9 and Company Exhibit 10, it is our intent to move --

25 to admit those at the end of Mr. Blank's testimony or

at the end of our case.

EXAMINER PIRIK: Are there any objections to Company Exhibit 5?

Hearing none, Company Exhibit 5 shall be admitted into the record.

(EXHIBIT ADMITTED INTO EVIDENCE.)

EXAMINER PIRIK: OCC with regard to OCC Exhibit 5.

MR. SMALL: We are not moving the exhibit.

EXAMINER PIRIK: Pardon me?

MR. SMALL: We are not moving the exhibit.

MR. KUTIK: I'm sorry, I didn't hear you, you are not moving it?

MR. SMALL: We are not moving the exhibit.

EXAMINER PIRIK: Competitive Suppliers, Mr. Petricoff, you had an Exhibit No. 4.

MR. PETRICOFF: Yes, your Honor. At this time we would move for admission of -- actually, your Honor, in light of the fact that it's -- let me ask the Bench a question.

That is merely a page that is now in a schedule that I believe will probably get -- will

1 probably be admitted as part of Exhibit 9. So it
2 would be somewhat duplicative.
3 On the other hand there are references
4 that are made to it in the testimony. What is your
5 preference?
6 EXAMINER PIRIK: I think since we marked
7 it yesterday, I think we should go ahead and pull it
8 in, and then we will worry about correctly citing it.
9 MR. PETRICOFF: Okay, thank you, your
10 Honor. In that case we move for admission of
11 Competitive Supplier Exhibit No. 4.
12 EXAMINER PIRIK: Is there any objection?
13 MR. KUTIK: No objection.
14 EXAMINER PIRIK: The document shall be
15 admitted into the record.
16 (EXHIBIT ADMITTED INTO EVIDENCE.)
17 EXAMINER PIRIK: Now turning to NOPEC.
18 MR. BREITSCHWERDT: Thank you, your
19 Honor, NOPEC moves for the admission of NOPEC

Exhibits 2, 3, and 4.

EXAMINER PIRIK: And those are titled Joint NOPEC and NOAC.

MR. BREITSCHWERDT: That's correct.

MR. KUTIK: No objection.

EXAMINER PIRIK: Any other objections?

Hearing none, those three exhibits shall be admitted into the record.

(EXHIBITS ADMITTED INTO EVIDENCE.)

EXAMINER PIRIK: Mr. Stone, with regard to your exhibits.

MR. STONE: Yes, Nucor would request the admission of Nucor Exhibits 1 and 2.

MR. KUTIK: No objection.

EXAMINER PIRIK: Any objection?

Hearing no objections, those two exhibits shall be admitted into the record.

(EXHIBITS ADMITTED INTO EVIDENCE.)

EXAMINER PIRIK: I believe that covers all the exhibits. Did I miss anything?

Okay. Thank you again, Mr. Warvell.

THE WITNESS: Thank you.

(Witness excused.)

EXAMINER PIRIK: Moving on to the next witness, I believe.

MR. KUTIK: Mr. Korkosz will address our next witness.

MR. KORKOSZ: The applicants call Mr. Vilbert.

MR. SMALL: Can we go off the record just a minute?

EXAMINER PIRIK: Off the record.

(Discussion off the record.)

(Witness sworn.)

EXAMINER PIRIK: Mr. Korkosz.

MR. KORKOSZ: Thank you, your Honor.

- - -

MICHAEL J. VILBERT

being first duly sworn, as prescribed by law, was examined and testified as follows:

DIRECT EXAMINATION

By Mr. Korkosz:

Q. Would you state your full name and professional affiliation, please.

A. My name is Michael J. Vilbert. I am a principal of The Brattle Group, a consulting firm headquartered in Cambridge, Massachusetts.

MR. KORKOSZ: Your Honor, please ask to have identified for the record Company Exhibit 8, a multi-page document styled Initial Testimony of

Michael J. Vilbert.

EXAMINER PIRIK: That document shall be so marked.

(EXHIBIT MARKED FOR IDENTIFICATION.)

MR. KORKOSZ: And also a multi-page document which I distributed to the parties yesterday

1 and is titled Errata Sheet of Michael J. Vilbert, I
2 ask to have that identified for the record as
3 Companies' 8A.
4 EXAMINER PIRIK: The document shall be so
5 marked.
6 (EXHIBIT MARKED FOR IDENTIFICATION.)
7 Q. (By Mr. Korkosz) Dr. Vilbert, do you have
8 what has been identified as Companies Exhibit 8 in
9 front of you?
10 A. Yes.
11 Q. Is that your initial direct testimony in
12 this proceeding?
13 A. Yes, it is.
14 Q. And do you also have before you what's
15 been identified as Companies Exhibit 8A?
16 A. I do.
17 Q. And is my understanding correct this
18 would -- that Exhibit 8A refers to various errata
19 that should reflect substitutions to information in

20 your direct testimony?

21 A. Yes, that's correct.

22 Q. Beyond what is reflected on Company

23 Exhibit 8A, do you have any other additions or

24 corrections to your testimony?

25 A. No, I don't.

Q. If I were today to ask you questions contained -- subject to Exhibit 8A, if I were to ask the questions contained in Company Exhibit 8, would your answers be the same?

A. Yes, they would.

MR. KORKOSZ: Dr. Vilbert is available.

EXAMINER PIRIK: Thank you.

OCC.

MS. ROBERTS: Thank you, we are just switching places so I can see the witness.

EXAMINER PIRIK: That's fine.

Can we move a microphone over in that direction? Preferably one with a long neck.

EXAMINER PRICE: The good one.

EXAMINER PIRIK: The good one with the long neck.

- - -

CROSS-EXAMINATION

By Ms. Roberts:

Q. Good afternoon, Mr. Vilbert, my name is Jackie Roberts, and I represent the Office of the Ohio Consumers' Counsel today.

A. Good afternoon.

Q. Dr. Vilbert, do you agree that companies with higher risks generally have higher returns?

A. They have higher expected returns. It frequently turns out that those expectations are not met, but on a forward-looking basis, they should have higher expected returns.

Q. In your testimony, Dr. Vilbert, marked as Company Exhibit 8 you suggest that you are not interpreting Senate Bill 221; is that correct?

A. I am interpreting it economically and financially but not legally.

Q. So in applying the test that you have proposed in your testimony, you've interpreted the Senate Bill but in your area of expertise?

A. That was my intention, yes.

Q. Thank you.

Dr. Vilbert, would you agree that standard deviation is a statistical concept used to calculate statistical significance?

A. The standard deviation is a statistical measure of the dispersion of a population or sample

20 of observations.

21 Q. And would that mean, Dr. Vilbert, that

22 applying standard deviations would provide no

23 information whatsoever about the accuracy of the

24 result whether the data in itself is accurate?

25 A. I'm struggling to understand the context

of your question. Could you rephrase it, please?

Q. The -- the statistical significance test evaluates, does it not, the variance in the data itself?

A. The standard deviation is a measure of how dispersed the data that you are looking at, that the standard deviation was measuring, that's what it is measuring, the dispersing of that data around the central tendency which is the mean.

Q. So for purposes of your testimony today, when you evaluate the returns of companies, the application of this statistical measure would not relate to the accuracy of the returns themselves but the variance of the returns?

A. I believe the answer to your question is yes. The returns themselves are the results of the sample selection process which is the method by which the accuracy, I think you are referencing, which in this case was whether it's comparable, that sample

20 selection process is the way you get to the accuracy

21 of the estimates. The standard deviation is just a

22 measure of how widely spaced are the observations.

23 Q. And doesn't using standard deviation

24 assume that the data will have a normal distribution?

25 A. The test -- the test that I apply is

1 based on a normal distribution and the underlying
2 data is not likely to be fully normal, but when you
3 select a sample, you get a sample that will have a
4 normal distribution if you select a large enough
5 group of companies.
6 Q. In fact, Dr. Vilbert, in your testimony
7 on page 19, line 8, do you address this?
8 A. I do.
9 Q. And turning to the sentence beginning
10 on -- on line 7, could you read that, please, the two
11 sentences beginning on line 7.
12 A. "The area in the tails of the
13 distribution could be somewhat more or less than
14 expected for a normal distribution."
15 By that what that means is more or less
16 observations in detail. In fact, a plot of the
17 sample returns show that the distribution is slightly
18 skewed to the right toward higher returns implying
19 that most likely the confidence level is somewhat

20 lower than 90 percent, which means that there could

21 be more than 10 percent of the observations in the

22 table.

23 Q. Would you agree that your data for

24 calculating significantly excess earnings contains

25 three outliers?

A. On the plot that I have I see at least two. There may be a third. I guess it depends on which line you are thinking is the third one but at least two.

Q. And which two do you identify, Dr. Vilbert?

A. Well, I don't have a name on them. This is just the numbers.

Q. That's fine.

A. I have one company at 19 percent and one company at 15.

EXAMINER PIRIK: Just for the record what are you referring to? You were looking at a chart.

THE WITNESS: This is a chart that I used to back up the statement that's in my testimony, but I didn't submit the chart in the record.

EXAMINER PIRIK: Oh, okay.

MS. ROBERTS: May I approach, your Honor?

EXAMINER PIRIK: Yes.

20 MS. ROBERTS: What I have asked --

21 EXAMINER PIRIK: Excuse me, could the

22 Bench have a couple of copies, please?

23 MS. ROBERTS: Oh, I always forget them.

24 I would ask that this exhibit be marked

25 as OCC Exhibit 6 for identification, document

1 entitled "Vilbert-Outliers," and it is comprised of
2 three pages.
3 Q. (By Ms. Roberts) Dr. Vilbert, are you
4 familiar with the SAS system?
5 A. In general, yes. I haven't used it in
6 years but, yes, I understand.
7 Q. And are you familiar with the univariate
8 variable calculation?
9 A. Can you be more specific what you have in
10 mind?
11 Q. In looking at this document that I have
12 given you on page 1, do you see that this is a method
13 of calculating outliers of your sample companies?
14 MR. KORKOSZ: May I inquire, is this a
15 document of Dr. Vilbert's?
16 MS. ROBERTS: I'm sorry.
17 MR. KORKOSZ: Is this a document of
18 Dr. Vilbert's?
19 MS. ROBERTS: No.

MR. KORKOSZ: I guess I object before going further that there be a foundation laid before examination proceed on the document.

MS. ROBERTS: Well, I was attempting to lay that foundation.

MR. KORKOSZ: Has the witness ever seen

this document before?

EXAMINER PIRIK: Could you please ask some foundation questions?

MS. ROBERTS: Yes.

Q. (By Ms. Roberts) In this document entitled OCC Exhibit 6 for identification, this document purports to use an SAS system, do you agree?

EXAMINER PIRIK: I don't think that's a manner in which to lay foundation. I believe the question is whether or not -- Dr. Vilbert, have you ever seen this document before?

THE WITNESS: No.

Q. Can you identify what this document calculates?

A. I see lots of numbers and statistical terminology, if that's what you are asking me, I can see that.

Q. Yes. And do you recognize the univariate variable calculation on the second -- second segment

20 of this first page?

21 MR. KORKOSZ: I renew my objection on

22 going further on this. I don't believe there has

23 been any foundation laid for the use of this document

24 in the examination of Dr. Vilbert and I object.

25 EXAMINER PIRIK: Dr. Vilbert has never

seen this document.

MS. ROBERTS: No. And this is the type of calculation he just explained that he did but did not attach to his testimony. And I would like to know whether he agrees that this was done properly or not. I think it's a fair area for cross-examination.

MR. KORKOSZ: I don't object to questions directed to Dr. Vilbert on how the calculation is properly performed. I do object to the use of this document in the course of that without foundation being laid for it.

MS. ROBERTS: I think if Dr. Vilbert doesn't understand any of the calculations on this document, he is an expert, he can say so.

These are the kinds of calculations he has testified that he does and did in this case to support his testimony.

EXAMINER PIRIK: If you want to lay foundation and you want to ask questions, be it

hypothetical or whatnot on how he did his calculation, that's fine.

This witness has never seen this document. And you are asking him to verify numbers that he is not even aware of how you arrived at them necessarily.

So you need to lay foundation for this document before you are going to be allowed to move forward on that.

Q. (By Ms. Roberts) All right. Dr. Vilbert, you testified that you did calculate what the outliers were of your comparable companies; is that correct?

A. No. I testified that I did a plot of the estimated total returns, return on total capital, and there are two numbers that are much higher than the rest.

I didn't perform the kind of analysis that was done here with the staff, the staff's program to determine on a statistical basis whether there are any outliers in my sample.

Q. And what kind of plot did you do? What were the X and Y axis of the plot? Was it a normal probability plot that you did?

A. No. It's simply a histogram of the

20 number of observations within each range of return on

21 total capital so, for example, if the return on total

22 capital was 9 percent for eight companies, I have a

23 little graph that says there's eight of them in that

24 box, and then on down the line to each of the ones

25 for every observation that I have.

I can show you a picture of it if you want to see it.

Q. That was a box plot, you said?

A. Histogram.

Q. Histogram.

A. It looks like that.

EXAMINER PRICE: Excuse us, we need to keep a record. "It looks like that" is not going to help us with the transcript.

MS. ROBERTS: It might be the answer.

THE WITNESS: I can certainly submit this picture, if you would like, but it's a histogram which is just -- it's a bar chart with the number of observations in each category.

EXAMINER PIRIK: If we are going to be referring to a document and that is the document you referred to earlier, then we are going to have it in the record.

MR. KORKOSZ: If your Honor, please, I

20 would ask that Company Exhibit No. 8B would be

21 reserved for the single-page document which there has

22 been some reference. We will provide copies for the

23 Bench and parties, and perhaps we can handle it that

24 way.

25 MR. McNAMEE: Would it be helpful to have

it now?

EXAMINER PIRIK: Can we hold on just a second, can I ask a question here? You said Exhibit 8.

MR. KORKOSZ: 8B. If I misspoke, I intended 8B.

EXAMINER PIRIK: Do we have copies of that document so that we can share that document?

MR. McNAMEE: We can make them.

MR. KORKOSZ: Can we go off the record.

EXAMINER PIRIK: Yes.

(Discussion off the record.)

Q. Dr. Vilbert, I will try to move on without Exhibit B and I think we might be able to do that.

If the outliers that were identified in your histogram, Exhibit 8B, were eliminated from your sample, is it fair to say that most of your data would then fall between 4 percent and 10 percent for

20 returns?

21 A. Since I don't have my histogram in front

22 of me at this point --

23 EXAMINER PIRIK: I think we are going to

24 have to wait for that question until the chart comes

25 back. I don't think that's a fair question at this

point.

Q. Dr. Vilbert, is that information also in Exhibit B10 attached to your testimony?

A. Are you referencing a page number?

Q. Your Exhibit B, pages B-11 and B12, is that -- is the data in your histogram also found on these pages?

A. It is. This is the -- on page B10 table B3 it lists the sample average return on total capital, the sample standard deviation, and then I calculate the total return threshold comes from that.

Q. And then the raw data for your calculations is found on B11 and B12?

A. Yes.

Q. Okay. And --

MR. KORKOSZ: Excuse me, if I may. I believe, just to clarify the record, that there is a table B3 referenced in the errata sheet. I think we ought to be sure what we are referring to.

20 EXAMINER PIRIK: Yes.

21 Q. If you look at the raw data listed on

22 pages B11 and B12, is it fair to say that with the

23 elimination of the outliers that most of these

24 returns for the electric companies fall between --

25 between 4 and 10 percent?

A. I see a few that are at 11 and I see --
but most are within the range that you specified.
Q. Thank you.
MR. KORKOSZ: If your Honor, please, I do
have copies available now that I can distribute.
(EXHIBIT MARKED FOR IDENTIFICATION.)
EXAMINER PIRIK: Yes, and we will --
we've marked that as Exhibit 8B.
Q. Dr. Vilbert --
EXAMINER PIRIK: Just a minute, please.
Could you just hold on just a minute until we all get
the exhibit and then we are going to have to go back
and lay foundation on this exhibit before we can
further move forward on this line of questioning.
Okay, Ms. Roberts, you can proceed, but
we need to lay a foundation on this document.
Q. (By Ms. Roberts) Dr. Vilbert, do you
recognize this document that has been identified as
8B?

A. Yes.

Q. And was it prepared by you?

A. My direction, my staff did it for me.

Q. Thank you.

And directing your attention to the X axis where it says 19 to 20 percent, would those

1 represent the outliers that we discussed?

2 A. We've been calling them outliers. They

3 are certainly higher than the rest of the sample but

4 keep in mind what we are doing in this exercise which

5 is to review the realized rate of return for a group

6 of companies that we believe -- I believe to be a

7 comparable sample.

8 Now, the fact that a particular company

9 in a particular year has a very high or very low rate

10 of return is a result of the outcome of various

11 economic events.

12 Next year that same company that you are

13 concerned about in this instance could have a much

14 lower rate of return, but it's certainly true, to

15 answer your question directly, that those returns are

16 much higher than the average of the rest of the

17 sample.

18 Q. And didn't you say in your -- your

19 prefiled testimony, Dr. Vilbert, that the sample was

20 skewed to the right?

21 A. Yes. And that's what this is

22 demonstrating.

23 Q. And this skew to the right of these

24 sample companies tends to increase the return on

25 equity that you recommended tends to increase the

return of equity on your calculation?

A. The sample average is higher than it would be otherwise because these companies are part of the sample average, yes.

EXAMINER PIRIK: I want to be sure the record is clear. This is a document that your staff created and essentially it takes the information off of Attachments B11 and B12 from your testimony and puts it in a -- in this form; is that correct? Because earlier we had information on B11 and B12 before we got the chart.

THE WITNESS: Yes, it's actually page, B11 and B12, it's table B4.

EXAMINER PIRIK: B4. Okay, I want to be sure it's clear those two pieces of the record were together. You may proceed.

Q. (By Ms. Roberts) Dr. Vilbert, on page B12 there appear to be two companies, No. 77 and 81, that have return on total capital of more than 20 percent;

20 is that correct?

21 A. Yes. If you look at the errata sheets,

22 there are actually different numbers, but United

23 Parcel Service is 23.99 percent and Hunt is at 23.8.

24 Q. It doesn't appear that these companies

25 are included in your histogram, are they,

Dr. Vilbert?

A. They exceed the part here that's cut off.

Q. So this -- this histogram extends beyond what's shown here; is that --

A. I think when it was printed out, they didn't put the last two columns in there is all that happened, but it's not showing up at the 23, you're right.

Q. So -- okay. So there should be two more companies listed beyond what's shown here at 23 to 24 percent; would that be correct?

A. Yes, but keep in mind that I'm basing my recommendation -- if you go to page B7, are you with me?

Q. I am.

A. I have a table B2 and you will see all capital intensive industries.

Q. Yes.

A. Notice that the mean of that is 8.6.

20 Q. Yes, I do.

21 A. If you go to table B3, you will see that

22 the mean there is 8.6.

23 Q. Yes.

24 A. The higher numbers that you are

25 referencing, the 70s tables, those companies, those

1 companies are in the categories that are below the
2 cutoff of the 8.60, and so they are not affecting the
3 sample average that I am using to recommend return in
4 this case. So they have been dropped out.
5 Q. All right. Thank you for that
6 edification.
7 I would like to spend a minute
8 understanding generally your statistical approach in
9 your testimony. And let's start with the purpose of
10 it.
11 I mean, do you agree that it's a
12 fundamental scientific principle that the screening
13 process should not drive the results themselves?
14 A. When you select a sample, the results
15 fall out of how you select the sample. But if
16 your -- if your -- the heart of your question is you
17 shouldn't arbitrarily tweak the selection process to
18 achieve a goal that you have in mind, I agree with
19 you there 100 percent. But I didn't do that.

20 Q. And in applying the scientific process

21 like this, you should also -- a screening process,

22 one must also be mindful that an inadvertent -- an

23 inadvertent inclusion of data samples does also not

24 drive the results; is that correct?

25 I don't want to do it intentionally,

give -- I don't want to go on and do it inadvertently.

A. Clearly I try to be careful on what I am doing, so I don't want to screw up the results by being careless, if that's what you are asking me, and I agree with that too.

Q. Okay. In performing your calculations you started by identifying companies of comparable business and financial risk; is that correct?

A. I describe my sample selection process. Let's see if I can find the page. But I start with considering financial risk but I start with considering the underlying assets first because the risk of the assets is divided between debt and equity.

And the purpose of finding comparable companies should be to focus on companies who invest in assets of comparable business risk and then control for differences in capital structure and

20 financial risk by taking into consideration the

21 amount of debt and equity in their capital structures

22 But I look first at the business risk of

23 the assets, whether they are regulated or not, the

24 type of customers they serve, residential,

25 commercial, industrial, and whether they serve

1 customers via a network of -- a network industry like
2 electric transmission, water transmission, natural
3 gas transmission, trucking, telecommunications, those
4 things that are all network industries,
5 Those are the basic ways I selected the
6 industries to include my sample.
7 Q. So you look at network industries that
8 were capital intensive.
9 A. Yes.
10 Q. And capacity turnover?
11 A. Capital intensive, yes, measured by
12 capacity turnover.
13 Q. Okay. And once you had selected a sample
14 using those criteria, what risk screening measures
15 did you apply to this group to ensure that they were
16 of similar risk?
17 A. I compared those characteristics of the
18 electric utility industry, of which FirstEnergy is
19 obviously a member, with those similar

20 characteristics of the alternative additional

21 industries that I included in my sample, and made

22 judgments about whether or not they were similar

23 enough to the electric utility industry to include in

24 my sample, but I --

25 Q. That's how you -- that's how you

1 determined the companies that would be in your
2 sample; is that correct?
3 A. Yes. And once I had them -- once I had
4 selected the companies -- once I had selected the
5 industries then I screened on some other factors like
6 bond rating.
7 I wanted to be sure they were investment
8 grade companies, that they didn't have dividend cuts,
9 those sorts of things, but I did not then try to
10 throw them or screen them out based on some other
11 additional measures of risk, such as Beta, which I
12 know some people have done.
13 Q. On Page 2, line 22 of your testimony, you
14 suggest that you compare the earnings of the FE
15 applicants to the average earned returns of companies
16 with comparable business risk; is that accurate?
17 MR. KORKOSZ: May I have the reference
18 again, please.
19 EXAMINER PIRIK: Yes.

20 Q. Page 2, line 22.

21 A. Yes.

22 Q. And then you apply a 1.28 times one

23 standard deviation to the companies' return on

24 equity; is that correct?

25 A. The statistical test that I am doing is

to take the average for the sample and recall, as I said, I restricted the sample to the capital intensive group which is 72 companies, I believe.

I took that mean, total return on capital, and multiplied to get the threshold for where a cutoff would be and say this is now excessive earnings

I used 1.2 standard deviations which is the way you cut off 10 percent of the observations in the tail, so 1.28 times the standard deviation gives you a cutoff, a threshold, above which you would expect to see 10 percent of the observations, and made the judgment that that is then significantly excessive earnings if you observe one that far away.

Q. But you did that to -- not to equity but to total capitalization; is that correct?

A. I did it to total capitalization, yes, but then I converted it to equity based upon the capital structures of the Ohio EDUs.

20 Q. Okay. And you didn't do the calculation

21 based on equity and then determine the total capital

22 costs?

23 A. I'm sorry, I don't quite understand your

24 question.

25 Q. And you didn't calculate the companies'

return on equity and then derive the total capital costs. You calculated based on the total -- companies' total capital and derived the equity cost; is that correct?

A. Each sample company from Value Line reports information that you can calculate the return on equity, the cost of debt, and from that I calculated the total return on capital. That's for every single company I did that.

I then calculated the average total return -- return on total capital for my sample, and made adjustments from that for the threshold but anticipated people would want to know what the equity return was.

I also adjusted that or converted that to an equity return, but the equity return depends on the capital structure.

so every time you have a different capital structure, you would have a different equity

20 return threshold, but the total -- return on total

21 capital threshold would not change.

22 Q. And that's how you got the results that a

23 return on total capital yielded -- or created a

24 threshold return on equity of 19.88 percent; is that

25 correct?

A. It's actually been corrected in the errata to 19.82, but the procedure that you have basically outlined is, in fact, correct, and that's displayed on table 4 on page 21 of my testimony.

Q. Yes. Thank you.

Now, Senate Bill 221 requires that in evaluating what excess earnings is for companies, you can't use information related to their affiliates or parent companies, does it not?

A. Yes, that's correct.

Q. All right. So if you turn to table 4 which you just referred to, just take me a second to find it.

Table 4 is the sample companies, aren't they?

If you turn to table 3 of your Appendix B, Dr. Vilbert, it appears that you have not included individual capitalization structures for each of the companies, Cleveland Electric

20 Illuminating, Toledo Edison, and Toledo Edison; am I

21 incorrect?

22 A. I used the same capital structure for all

23 three and that is consistent with testimony I

24 submitted in the rate case that we just finished, and

25 these were the capital structures for all three of

1 them in that rate case.

2 If the capital structures were different,

3 I think I show this in one of my tables, the ROE

4 would change, but the underlying totals -- return on

5 total capital would not change.

6 Q. Does -- does the statute SB-221 require

7 the use -- you to use a ratemaking equity -- or

8 ratemaking capitalization for this calculation?

9 A. No. This is simply an illustration of

10 how you would use the methodology based upon a

11 capital structure to determine the threshold that --

12 I am just looking to see where I have the table where

13 I make those adjustments to show you.

14 If you look on page 22, if you look on

15 page 22, I've displayed capital structures with 45

16 percent equity, 49 percent equity, 50 and 55 percent

17 equity.

18 Notice that in the row labeled "Return on

19 Total Capital" that doesn't change at 11.67 but the

20 implied equity return threshold changes. It goes

21 down as you increase the equity thickness because you

22 now have more equity to measure the return against

23 and so the threshold should be reduced.

24 The 49 is an example. You could have

25 used any number in the methodology, works exactly the

same way for each of them.

Q. But if you use the actual capitalization of the companies, you could have used the actual capitalization of the companies, couldn't you, Dr. Vilbert?

A. Certainly. When you do this test next year, you would simply substitute the equity thickness for whichever company you are measuring excessive earnings, plug it in, and you're all done.

Q. Well, that may be so, but in terms of determining what the threshold should be for applying next year, whether you use the actual capitalization of the companies or your hypothetical calculation, would create a different threshold, would it not?

A. Yes and no. The yes -- the no part is the 11.67 is the metric that establishes whether or not excessive earnings have been realized.

The capital structure determines what the ROE cutoff will be, and if the capital structure is

20 different from 49, the ROE threshold would be

21 different from 19.88 or 19.82 corrected, it could be,

22 if they had 55 percent equity would be 18.13.

23 The point is that you must take the

24 equity thickness into consideration when you make a

25 judgment about whether or not they have had excessive

earnings. Lower equity, higher threshold; more equity, a lower threshold.

EXAMINER PIRIK: I just want to be sure to point out the record notes this is an errata items so some of the figures you are meaning are different on the errata item, so we need to --

THE WITNESS: Right. I should say that the errata comes from one company that we left out and we realized that we omitted one that should have been in and the numbers all changed because you include one more company. And I apologize for that.

We should have caught it the first time but we didn't but that's -- that's the essence of that change is one company was omitted.

Q. So there's a distinction, Dr. Vilbert, between the hypothetical capital structure you use for the three companies and whether the three companies should be averaged together for the excess earnings test threshold?

Are you just suggesting you used hypothetical capital structures or are you also proposing the companies should be averaged together for the purpose of the excess earnings threshold calculation?

A. I didn't make that proposal that they

should be aggregated. I saw numbers similar to that in Mr. Cahaan's testimony, but I did not make that proposal.

All I was doing with my testimony is to provide you a methodology to calculate the threshold following the law as carefully as I could, at least I thought I was trying to do it as carefully as I could, to get the numbers so you can see how the methodology works.

And as I say, the threshold changes for the capital structure that you return on; total capital does not.

Q. And I think finally regarding table 3 that we were just discussing, page B10 of your testimony.

You show in the top segment of data that you used an Ohio EDU cost of debt of 6 percent; is that correct?

A. Yes. This is -- again, this is simply a

20 hypothetical number to stick in the calculations to

21 show how the methodology works.

22 I wasn't trying to conduct the test today

23 for 2009 or whatever. I am just showing you how it

24 works.

25 Q. Okay. If you turn to table B34 of your

1 testimony, Dr. Vilbert, if -- if you look at the
2 electric utility group which is all contained on page
3 B11, were there -- how many companies in this group
4 of 47 companies earned a return on total capital of
5 11.67 to 11.73 percent?
6 A. I don't -- there's none of the first -- I
7 am on actually the errata sheet, but none of the
8 first 48 companies that I see have a return greater
9 than 11.67 percent.
10 But keep in mind that threshold is
11 designed to be the case in which we are determining
12 that the company has significantly excessive
13 earnings.
14 This is our sample company that is
15 supposed to be normally -- distributing normal
16 returns, and so the fact that there is none at 11.67
17 is not surprising.
18 Q. The standard deviation method as you have
19 applied it captures 90 percent of comparable

20 companies based on your measures of business risk; is

21 that correct?

22 A. Let me say it back to you slightly

23 differently than you said it to me, just to be sure

24 it's clear.

25 The sample -- the distribution of return

on total capital that I observed from my sample using a cutoff of 1.28 standard deviations above the mean means that on average 10 percent of the observations will be greater than that and 90 percent of the observations will be less than that.

Q. And, yeah, all right.

I am trying to understand how that relates to my question about the selection. You have -- you have a sample of comparable let's just use electric companies, comparable risk, capital intensive, similar turnover, and yet only one of them -- only one of that sample of comparable utilities achieves what you would consider to be an excess earnings threshold.

A. Well, let me take you back.

Q. It seems like it may not be a threshold that captures enough companies. That's what I am trying to understand.

A. Recall the law says that comparable

20 companies, including utilities, which I read to mean

21 that the law envisioned a sample that included not

22 just regulated electric utilities or even regulated

23 utilities but some companies in addition to that.

24 The question is, which the law didn't

25 specify, what are those other companies.

I selected, as we spoke earlier, 72 companies that were the -- what I thought the most representative of what the law is looking for.

That group of 72 companies has a distribution such that the cutoff that we are talking about has 10 percent of the observations from that sample and detail.

Had the distribution or the sample been restricted to regulated electric utilities, the 48 companies that we have listed here, the sample mean and the sample standard deviation would have been different.

But that's not what the law said to do. The law didn't say select a sample of regulated electric utilities and determine excessive earnings, significantly excessive earnings.

It says pick a sample, include regulated -- including utilities, and if you do that, you would get a distribution that would look

20 different than if you had restricted it to electric

21 utilities or water utilities or any other subset.

22 Q. I understand that, Dr. Vilbert, and I

23 guess I should have said by way of example let's just

24 look at the electric utilities, but if you look at

25 your -- at your universe of companies, there are --

including various other differences there are still only a couple of all these companies that would exceed your threshold of to -- to qualify as having significantly excess earnings; isn't that correct?

A. On average only 10 out of 100 will exceed it. That's what the distribution is telling you. So you wouldn't expect to see too many in the first 48 anyway.

Q. If you include all of them, you might expect to see 8, won't you, if it were 10 out of 100 and you have 80 samples?

A. Something like that you would expect if -- if the standard deviation and the mean are properly measured, and I believe they are, then on average you would observe 10 out of 100 in the tail.

Q. So if you're -- I am just trying to understand as a process applied to Ohio you have a sample of data points that you had said in your testimony is skewed to the right, and then when

evaluating the results of your sample, it seems as though fewer than expected or fewer than you would expect on average of the companies hit the excess earnings test.

It seems that in this case the test may not produce a result that is appropriate for Ohio.

1 That's what I am trying to understand.

2 And I guess you've explained that in

3 discussing how you applied the test and how you

4 measured the risk.

5 A. May I respond?

6 MR. KORKOSZ: Is there a question there?

7 MS. ROBERTS: Yes, uh-huh.

8 MR. KORKOSZ: What is it?

9 MS. ROBERTS: He is going to respond

10 to --

11 EXAMINER PIRIK: Do you need the

12 question, Dr. Vilbert?

13 THE WITNESS: I think I understand her

14 point, and I have a response point, if that's okay.

15 MR. KORKOSZ: Sure.

16 THE WITNESS: You -- you -- the

17 process -- the process that I undertook was to select

18 a sample of companies as comparable as I think is

19 possible to select a sample of companies.

I measured the return on total capital and the standard deviation of that sample of companies. That then giving me a distribution for return on total capital that I have observed from my sample.

Now, any time you do a sample, you are

1 going to have results that vary from what you would
2 expect.
3 But I set the numbers up such that on
4 average for this -- for this group of data you would
5 expect to see 10 percent of the observations in the
6 tail greater than the number that I have calculated,
7 which is 11.67.
8 But if do you this experiment a number of
9 times, sometimes you'll have 15 in the tail,
10 sometimes you'll have 5 in the tail.
11 It's when you go to Vegas and you are
12 playing Blackjack or you are playing roulette,
13 sometimes the number comes up a lot of times in a
14 row, that just happens by chance, but statistics say
15 that on average 10 percent of the time based upon
16 this metric you would find observations greater than
17 11.67 percent return on total capital. Not every
18 time but on average.
19 And so whether -- I think it applies to

20 the Ohio EDUs because you are trying to determine

21 something that the law leaves kind of vague in my

22 mind, which is what is -- what does it mean to be

23 significantly excessive earnings. It's not defined

24 and so what I've given you in my testimony is a way

25 to address that problem.

1 Q. If you turn to your testimony, page 9, do
2 you have that?
3 A. Yes.
4 Q. The answer commencing on line 3, could
5 you read those first two sentences, please.
6 A. "It depends. The purpose of the test is
7 to identify significantly excessive windfall profits.
8 If such profits would be classified by accounting
9 rules as extraordinary or nonrecurring items or are
10 otherwise nonrepresentative of utility operations,
11 then they should be excluded from the measure for the
12 utility in order to maintain comparable with the
13 sample."
14 Q. First, I would like to talk about your
15 characterization of windfall profits. Did you see
16 that in the statute that --
17 A. No, that's my language.
18 Q. That's your language. And that's your
19 characterization of what significantly excessive

20 earnings is?

21 A. When I read the statute, I was trying to

22 figure out what the statute in this section was

23 trying to guard against.

24 And I think or at least I believe what

25 you are trying to guard against is that somehow rates

are set or the plan is set in such a way that the utility makes a lot more money than it should have made in the process or that was expected to be made in this process. I call that windfall profits.

Q. All right. Turning to the nonrecurring items that you would remove from the calculation, you look at Attachment H, and I believe you support this attachment in your testimony to the extent it addresses excess earnings; is that correct?

A. I was supporting the Roman number -- or the little "i" part of it.

Q. Okay. And if you look at the double little "i"?

A. And that is I think Mr. Harvey talks to that point.

Q. Is the kind of -- is the kind of write-off that's described here the -- the kind of extraordinary or nonrecurring item that you think should be adjusted for in your calculation?

20 A. Yes. This is what I had in mind. As I
21 understand, there is going to be potentially a
22 write-off of some regulatory assets which will come
23 out of the equity portion of the companies' balance
24 sheet, and the hypothetical situation that I was
25 trying to guard against with this question was

1 nothing changes between year one and year two except
2 for the write-off.
3 They don't earn any more money. Nothing
4 changes but the measured return on equity would
5 change dramatically if you write off a substantial
6 part of your equity base, and so I was trying to
7 guard against that seemingly illogical outcome.
8 Q. And are you aware that the company may
9 have proposed a write-off of goodwill?
10 A. Yes.
11 Q. And would you consider that to be a kind
12 of nonrecurring item that should be adjusted for in
13 your calculation?
14 A. Yes. To the extent that the revenues
15 haven't changed, nothing else has changed and all
16 that's happened is you've reduced the denominator of
17 the calculation for the return on equity.
18 I don't think that should then generate a
19 determination that we've had significantly excessive

20 earnings.

21 Q. Even if the revenues were to change as a

22 result of this Commission allowing the company to

23 recover for additional costs on an ongoing basis,

24 would you adjust for that type of item in your

25 calculation?

A. Can you be more specific what you have in mind? I don't quite understand the question.

Q. Any costs of service or to provide service requested by the FE applicants that the company authorizes as a result of this case.

MR. KORKOSZ: Speaking of this electric service plan case?

MS. ROBERTS: Yes.

A. The return on equity calculation is net of all costs. So if all costs were to increase and the revenues were to increase commensurately dollar for dollar, it would not affect the net income at all. And so there would be no need to make any adjustment for that.

If net income is unchanged but the denominator of the calculation, the equity dollars against which you are going to measure the rate of return, if that goes down dramatically, everything else can be the same but all of a sudden you now seem

20 to have excess earnings when the year before with the

21 exact same revenue and earnings was not excessive.

22 That seems wrong to me.

23 MS. ROBERTS: Thank you, Dr. Vilbert.

24 That concludes my questions.

25 EXAMINER PIRIK: We will go off the

record for a minute.

(Discussion off the record.)

EXAMINER PIRIK: We will go back on the record.

Commercial Group.

MS. WUNG: Thank you, your Honor, we have no questions for Dr. Vilbert.

EXAMINER PIRIK: Mr. Rinebolt.

MR. RINEBOLT: Just a couple of questions, your Honor.

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CROSS-EXAMINATION

By Mr. Rinebolt:

Q. Good afternoon, Dr. Vilbert.

A. Good afternoon.

Q. Just a couple of quick questions. I want to start at page 3 of your testimony.

Q. You talk in terms of normalizing or the need to remove normal variations. Do companies keep

20 information based on a fiscal year financial

21 information?

22 A. It's my understanding that most, if not

23 all, do.

24 Q. And then that determines what the

25 revenues are for that year, I mean, that's what's

1 reflected in that financial page?

2 A. The revenues for a year are reported in

3 the fiscal year reports.

4 Q. Right. And then when we set regulated

5 rates in a proceeding, those are again based on a

6 test year generally?

7 A. Generally.

8 Q. Okay. So if we are looking at a point in

9 time and we are looking to determine whether in a

10 point in time in a year whether or not there were

11 excessive earnings, why do we need to normalize or

12 average those earnings in order to set a -- to

13 determine that number?

14 A. I'm not following the question.

15 Q. Well, you discuss in your testimony at

16 several places that earnings should be averaged over

17 a period of time to -- so that when you do the

18 analysis as to whether they are significantly

19 excessive, they are an accurate reflection of the

20 companies' revenues, but we're looking at these

21 revenues on an annual basis, why can't we look at

22 revenues on an annual basis to determine whether

23 there is significantly excess in?

24 A. We seem to have a point of confusion

25 because I do the tests on an annual basis. The

1 revenues that I am looking at are annual. The sample
2 companies' revenues are annual.
3 I do some averaging which is I average
4 the beginning of the year and end of year total
5 capital because I believe that that is a better
6 measure of the total capital in place to generate
7 those revenues over a year
8 But I use the data for an annual period
9 in the calculations. Maybe I am misunderstanding
10 your question.
11 Q. Maybe I misunderstood your testimony so
12 that will resolve -- that helps clarify it for me.
13 On page 9 of your testimony, in line 3,
14 you indicate the purpose of the test is to identify
15 significantly excessive windfall profit. The term
16 "windfall" doesn't appear in the statute to your
17 knowledge, does it?
18 A. No. And in retrospect I wished I hadn't
19 put it in, but it was just the way I was thinking

20 about the issue.

21 Q. Well, okay. Then finally back on page 17

22 of your testimony, you move into a discussion of

23 asymmetric risk and the danger of false positives.

24 Now, let me see if I understand exactly

25 what the concept is here. What -- are these

adjustments that you are talking about essentially -- is the outcome of them to lessen the risk that the companies will, in fact, run afoul of the excessive earnings test?

A. You confused me. Are we talking asymmetric risk or are we talking about adjustments?

Q. The discussion concludes with a piece on asymmetric rates but the adjustments that you make, is the effect of those adjustments to make it less likely that the companies' earnings would be determined to be significantly excessive?

A. You did point me to page 17, didn't you?

Q. Right. The discussion starts on page 16, I believe.

A. The discussion on page 16 talks about if you were to restrict the sample to only regulated electric utilities and then --

Q. And then on 17 at line 14 you talk about why it's important to guard against false positives.

20 A. Yes. But I'm not making any -- are you

21 talking about adjusting the significance level? I'm

22 trying to understand your question so I can answer

23 it.

24 Q. I guess let me put it another way.

25 Your discussion of which companies

1 constitute comparable companies for the determined --
2 the purpose of determining whether revenues are
3 significantly excessive -- withdraw.
4 Define for me what you mean by a "false
5 positive."
6 A. A false positive in this case is a
7 determination that the company has earned
8 significantly excessive earnings and, therefore,
9 would have to refund the money when, in fact, they
10 did no such thing. It was just a normal fluctuation
11 in rates of return that are realized by all
12 companies.
13 Q. And so what do you recommend be done to
14 guard against a false positive?
15 A. Well, that's why the guard against false
16 positives is where you set the earnings threshold for
17 determination of excessive earnings.
18 If you -- if you set the threshold very
19 low, for example, if you set it at the mean of the

20 sample companies, then 50 percent of the time the

21 company would be determined to have excessive

22 earnings, and you would have them refunded.

23 50 percent of the time they would be

24 below the mean, they wouldn't get a refund. And so

25 that means that a large part of the time you are

1 going to be determining excessive earnings when there
2 were likely none in place.
3 And that's also the asymmetric risk I was
4 talking about in a world in which if you earn too
5 much, you must refund, but if you earn too little,
6 you get nothing; that's asymmetric.
7 Q. So what you are saying -- but the impact
8 of this analysis -- of this discussion and the
9 elimination of asymmetry in the risk by balancing it
10 more, that -- that net effect of that is to reduce
11 the likelihood that the company will be found to have
12 significantly excessive earnings?
13 A. Yes. I'm trying to set a test up that
14 balances the needs of the customers to be protected
15 against the adverse consequences of setting up a test
16 that is so tight that the company fails to -- fails
17 the test frequently, refunds money, which has the
18 result on average then that they would not normally
19 then earn their cost of capital over time.

MR. RINEBOLT: Thank you very much, Dr. Vilbert. That's all my questions.

EXAMINER PIRIK: Mr. Randazzo.

MR. RANDAZZO: No questions.

EXAMINER PIRIK: Mr. Smith.

MR. SMITH: Yes.

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CROSS-EXAMINATION

By Mr. Smith:

Q. My name is Craig Smith.

When you were preparing your testimony, you did read the statute, correct?

A. Yes.

Q. Okay. And did you receive advice of counsel what the statute meant?

A. I asked counsel on a number of occasions what he thought it was trying to say in some aspects of it, because I didn't understand some of it.

I focused on the economics. There are parts of it that seem legal to me, and I was trying to understand what that meant, but the short answer is nothing he told me had any affect on my economic interpretation of the statute.

Q. Well, is it --

EXAMINER PIRIK: Mr. Smith, could you use

the microphone, please? I don't think it's picking you up.

MR. RINEBOLT: Is it on?

EXAMINER PIRIK: You just need to pull it closer.

MR. SMITH: It was off.

EXAMINER PIRIK: There you go. Now, it will work.

Q. (By Mr. Smith) So the part of the statute you are really focusing on is the test for significant excessive earnings.

A. Yes, sir.

Q. Now, in developing that test, did you take note that the statute provides a measurement which is basically excessive earnings is whether the earned return on common equity of the EDU or the electric distribution utility is significantly in excess of return on common equity during the same period of publicly-traded companies?

Did you emphasize that language in your analysis?

A. Yes.

Q. Well, is total capital -- does that include more than just the common equity of a corporation?

20 A. It does. The statute also says taking

21 into consideration capital structure. And in order

22 to evaluate a company's return on equity, it's

23 meaningless to do that without consideration of

24 capital structure.

25 Q. So you are relying on that part of the

statute to expand the measurement from common equity to total capital; is that true?

A. Yes. My job or my process was to try to read the language of the statute and to develop a test that is consistent with the statute but also makes sense from a financial -- financial and economic point of view.

And as I mentioned a moment ago, to simply compare rates of return on equity without consideration of differences in the capital structure in my judgment is a meaningless exercise and should not be what is done as a way of determining significantly excessive earnings.

Q. Do you recognize that it's the Commission's responsibility to implement the statute?

A. Yes. And what I am trying to do is give them the best advice I can on how to follow the statute from an economic and finance point of view.

Q. Now, does your test -- can that be

20 universally applied throughout Ohio to the other

21 EDUs?

22 A. Yes, I believe it could. There may be

23 some adjustments of the sample or of the cutoff for

24 companies that own their own generation versus those

25 who do not.

But with that caveat this approach could be used universally. In fact, when I developed it, I had it mind it would be used in that fashion.

Q. But isn't one of the main characteristics of the FirstEnergy's operating companies is the lack of generation?

A. They no longer own their own generation. That's true.

Q. And that affects the revenues they receive?

A. It certainly affects their net income.

Q. That's true. And -- now, do you have an understanding of how this excessive earnings provision fits into the overall regulatory scheme recently implemented by the General Assembly?

A. I would say that my understanding is pretty superficial, so I don't think I have the ability to comment one way or the other on that.

Q. So you did not take into consideration

20 how this statute applies in the overall fairness line

21 between the companies and the ratepayers?

22 A. No. My testimony is -- deals with how do

23 you implement the language of the statute to

24 determine significantly excessive earnings in the

25 context of the statute for an ESP. I didn't try to

go beyond that relatively narrow goal.

MR. SMITH: No further questions.

EXAMINER PIRIK: Thank you.

Mr. Bell.

MR. BELL: Thank you.

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CROSS-EXAMINATION

By Mr. Bell:

Q. Good afternoon, Doctor. My name is Langdon Bell, and I represent the Ohio Manufacturers Association.

A. Good afternoon.

Q. Would you turn to page 3 of your testimony, your answer 10 to question 10.

You take -- state significantly excess, therefore, suggest a statistical test and it is on that basis that you are proffering simply a statistical test for the measurement, are you not?

A. Yes.

20 Q. Now, does a statistical test to measure

21 substantial excess earnings eliminate the need for

22 the Commission to exercise judgment as to the cause

23 of those excess earnings?

24 A. No, I don't think it does.

25 Q. Let me put it this way, you indicate in

your testimony that to the extent this is a look backward test and not a look forward test it's more appropriate to use accounting data as opposed to market data, do you not?

A. I say that plus it's impossible to conduct the backward looking test on market data because if you take out all of the subsidiaries and other parts of it, the only thing you have left is accounting data. You can't do it on a market basis.

Q. Along that same line I think you had indicated that some of your colleagues utilize market data, i.e., use of a Beta for purposes of identifying excess earnings that you chose not to use in this case?

A. I have read testimony in the other cases just because I was curious about how they did it compared to how I did it, and many of them used a measure Beta to help them select the sample.

Q. Why do you believe that your method is

more preferable to their method which utilizes Beta?

A. Well, first, let me caveat by saying I don't want to talk about their testimony. I will tell you why I chose not to use Beta in my testimony.

Q. That would suffice for purposes of responding to my inquiry.

A. Beta is a measure -- first of all, it's estimated using market value, market return data, and it's a measure of the business risk of the equity and the financial risk of the equity.

So it is possible to have a company or two companies that have identical Betas, let's just pick a number, .9, for example,

One of those companies would be a regulated utility and have 50 percent, 60 percent debt, the other company, an unregulated company, with 20 percent debt or very little debt.

The underlying assets of those two companies, the business risk of those two companies, could be quite different and, therefore, choosing based upon Beta seems to me to lead you to a situation in which, although the Betas are similar, the underlying assets that the companies invest in could be quite different.

Q. Are you suggesting that the use of that

20 methodology does not accurately reflect the

21 differences in business risk?

22 MR. KORKOSZ: Is that methodology Beta or

23 Dr. Vilbert's?

24 MR. BELL: Beta.

25 A. I'm saying I don't know whether it

1 adequately reflects business risk or not in the --
2 the way you asked the question.
3 I'm saying instead that it's possible to
4 have two companies with an identical Beta but very
5 different underlying business risk of the companies.
6 Q. Let's go back to my initial area of
7 inquiry.
8 Now, as I understand it you're suggesting
9 to the Commission that it's excessive earnings test
10 looks at reported earnings, correct?
11 A. I don't think --
12 Q. In a given time period?
13 A. I don't think there is any other way to
14 interpret the statute but that.
15 Q. Okay. And if that is, in fact, the case,
16 if those reported earnings reflect imprudent
17 occurrence of either capital or operating costs,
18 should the Commission consider in the exercise of its
19 judgment the incurrence of such costs and whether or

20 not such costs have the affect of reducing the

21 possibility of the company earning excess revenues?

22 A. For clarity, you are asking me about Ohio

23 EDUs -- returns on equity?

24 Q. Yes. Or as you might measure based upon

25 FirstEnergy, the holding company, to the extent we

1 aren't actually measuring the capital structures of
2 the individual companies, operating companies, we
3 jump back and forth.
4 A. So your question is if the company made
5 impudent -- or imprudent, excuse me, investment or
6 expenditures of costs in some way that that should be
7 taken into consideration by the Commission?
8 Q. Yes.
9 A. I think the Commission does that sort of
10 thing routinely, do they not, in they evaluate --
11 Q. Should they in the context of a
12 determination of whether excess earnings result?
13 Substantial excess earnings?
14 Let me be more poynant.
15 If CEI, Toledo Edison, or Ohio Edison
16 entered in to a supply agreement with another
17 affiliate that would render it virtually impossible
18 for those operating companies to place themselves in
19 a position of excess earnings, should the Commission

consider that?

A. Well, the way I understand these things to work, you would -- the Commission would, at the time they enter into these agreements, make a judgment as to whether these transactions were prudent.

It would, I think, be improper to say, oh, well, it turned out differently than we thought and now we decided it's imprudent ex post and, therefore, we are going to penalize the company.

I think these are done up front, aren't they?

Q. Well, I'm not so sure.

Let's look at that, if you will. Let me give you a hypothetical. And this is not meant to be inflammatory, but I think it highly illustrates the point that I am making.

If the operating companies here were desirous of avoiding excess earnings, might they perchance substantially increase executive salaries to a point equivalent investment bankers' salaries of recent years in order to -- which would have the effect of reducing the possibility of their making substantially excess earnings?

MR. KORKOSZ: I object.

Q. Is that not a possibility?

MR. KORKOSZ: I object. Argumentative, speculative, and argumentative.

EXAMINER PIRIK: Mr. Bell, do you have a response to that?

MR. BELL: Yes, I do. It is -- the

1 applicants in this case that incur costs on an annual
2 basis, they have control. They have control of their
3 capital structure, not the ratepayers.
4 EXAMINER PIRIK: I will overrule the
5 objection.
6 Do you remember the question?
7 MR. RANDAZZO: It was the noninflammatory
8 one.
9 Q. (By Mr. Bell) The incurrence -- the
10 imprudent incurrence of cost within a period in which
11 the earnings test is being applied would have the
12 effect of minimizing the companies' exposure to
13 excess earnings, would it not?
14 A. Let me answer the question that you're
15 trying to pose, I think, this way, you're setting --
16 you are arguing or trying to determine the ESP plan
17 for the Ohio EDUs and in that plan is a rate of and a
18 set of costs that are being considered.
19 If it were the case that the company

20 could somehow manipulate their costs in such a way

21 that they would seem to make their costs higher than

22 they would otherwise be, that would reduce their net

23 income and, therefore, mitigate the chance of

24 exceeding the threshold of excessive earnings.

25 On the other hand if the rates are set

1 and they decide to spend money some way that has the
2 effect of eroding their profit, it seems to me they
3 are the losers in that case. They don't gain
4 anything by doing that. What if it's a case where
5 the company did not bear the risk of those imprudent
6 costs being assumed by the ratepayers of these
7 operating companies but, in fact, it's the ratepayers
8 that directly assume the risk via riders that allow
9 the company to automatically pass on to the
10 ratepayers of CEI, Ohio Edison, and Toledo Edison
11 costs that may be totally imprudent that they have
12 incurred from operating affiliates, coal mines,
13 transportation?
14 A. These things would have absolutely no
15 affect on the excessive earnings test if it is, in
16 fact, costs, because costs don't -- if your
17 pass-through costs, dollar for dollar, net income
18 which is the thing you are going to use to measure
19 excessive earnings, would be completely unaffected.

20 Q. And that would be true, for instance, in

21 the incurrence of any cost because of the cost --

22 costs?

23 A. If I understood your question, sir, you

24 said if there is a rider that the company incurs

25 higher costs than you believe they should and they

pass that through to ratepayers, dollar for dollar net income is not affected at all and so the excessive earnings test would be unaffected.

Q. Is it your position that the substantial excess earnings test has as its ultimate objective allowing the company over time to earning its cost of capital on average as you testify on page 18, line 7 of your prefiled testimony?

A. No, that's not the purpose of the excessive earnings test. That regulation, the purpose of regulation in my judgment in terms of setting the allowed rate of return is to allow the company on average to earn its cost to capital over time because some years they will earn a little more, some years earn a little less.

The purpose, as I understand it or have interpreted the statute to say with the excessive earnings test, is to protect ratepayers against the possibility that the way rates are set for electric

20 utility, in this case the EDUs, for some particular

21 period of time result in the company earning too much

22 money.

23 Q. Your statistical test, the methodology

24 that is employed by you would allow any one of these

25 operating companies to in any given year receive what

1 might otherwise be perceived as excessive earnings,
2 would it not? 20, 25 percent earned return on
3 equity --
4 A. No.
5 Q. -- in that year?
6 A. No.
7 Q. It would not?
8 A. No. The cutoff that I recommended, the
9 highest one, I believe, for a company with 49 percent
10 equity was 19.8, so it wouldn't get to 25. 25 would
11 be excessive.
12 Q. That raises an interesting area of
13 inquiry, Doctor. Did you by any chance test, if you
14 will, the results produced by your excess earnings
15 test insofar as attempting to determine what would be
16 the revenue entitlements of the companies applying
17 this -- that test and the difference between the
18 earnings it is now requesting in its ESP and the
19 earnings that you state the company would otherwise

20 be entitled to?

21 A. No, I did not -- I did not do such tests.

22 Q. Could that evaluation be made, Doctor?

23 Quantification?

24 A. Sure. It would be a simple matter if you

25 know how much equity the firm has in dollars, and you

say 19 percent or 19.8 is the cutoff, you multiply the two together, you could figure out how many dollars of equity return you would need before you would exceed the threshold.

Q. And how would you then compare that threshold with the return on equity resulting from the ESP as proposed by the company?

A. I don't understand your question.

Q. Well, you are not applying your threshold test to the earnings of this company, are you?

A. I have proposed a methodology that could be used when the time comes to apply to the earnings of the company.

Q. Thank you.

You have not applied your test to these companies. You have set forth by way of illustration how your test should be applied. You have not applied it here, have you?

A. No, I have not. The data doesn't -- it's

20 2009 is the first time we are going to do the test,

21 so we are not there yet.

22 Q. So for purposes of the Commission in

23 determining whether or not your test is in its

24 judgment appropriate for the Commission to apply, we

25 don't know the results produced by applying your test

to these companies, do we?

A. As per the specific test results for 2009 we don't know, I have given you an example based upon the sample selection process, the specific numbers for the sample companies what the test would tell you if you were doing it today based upon the sample as I have selected it.

Q. The adjustments that you suggested, I would like to touch on that for a moment, if I might, Doctor.

Are you aware of the fact that the company out of the kindness of its heart has suggested that it would waive or swallow certain regulatory assets that it currently has on its books?

MR. KORKOSZ: I object to the pejorative nature of that question.

Q. I will rephrase it.

Are you aware whether or not in the ESP case before the Commission the company is willing to

20 waive the collection of certain regulatory assets?

21 A. Yes.

22 Q. But it does not want to write off those

23 regulatory assets from its accounting books for

24 purposes of applying the excess earnings test; is

25 that correct?

A. I believe that's -- you are saying it in a way that I think I agree with.

Q. All right.

A. But in general I think you are accurate.

Q. Thank you, sir.

Then in effect while the company is representing that it is writing off the asset, it is, in fact, recovering the asset in the return component on the excess earnings test, is it not?

A. I disagree with that characteristic -- characterization completely.

Q. Well, if it is entitled to greater earnings than it would otherwise be entitled to, as a result of including in the asset base upon which the earnings are computed or derived, assets that are written off, doesn't that affect -- have the affect of providing for a return in terms of dollars of the companies' investment, the shareholders' investment in the asset in the form of a higher return than

20 would otherwise be permitted?

21 A. If I understand the question you are

22 asking me, I think you're mixing a number of things.

23 They have a regulatory asset on their books that they

24 are going to write off.

25 Q. And from an --

MR. KORKOSZ: May the witnesses be permitted to finish his --

EXAMINER PIRIK: Yes.

MR. BELL: I apologize.

A. Those are dollars that they had been promised. That's what a regulatory asset is, that they have already expended these dollars and they have a promise, regulatory promise to be able to recover them.

They are now not going to be able to recover those dollars. Those are dollars they have already expended that they are never going to recover.

The purpose of the adjustment that I am recommending is we now have a write-off that will come out of the book value of equity, and as I was talking about earlier on the thought experiments, if you write off assets in year two and you have not changed anything else such that you were not deemed

20 to have excessive earnings in period one and the only

21 thing that changes is that your denominator of your

22 test statistics is now different and you are now

23 judged to have significantly excessive earnings, that

24 is illogical to me because, first of all, you wrote

25 off the dollars you are never going to recover and

now you want to penalize the company for having a metric that seems to suggest they are earning too much when nothing has changed.

Q. Is there not another perspective by which those transactions can be reviewed or be viewed? That being that I as a company am reporting on my financial books, reporting to the public in my financial statements that I am writing off an asset doesn't, in fact, tell the investment community, the public as a whole, I am giving up by that write-off a right to the return of that capital as well as a return on that capital investment that I have just written off?

MR. KORKOSZ: I object. Relevance. We are well beyond any discussion that was significantly excessive earnings test.

EXAMINER PIRIK: I am going to sustain the objection. Go ahead and move on.

MR. BELL: Thank you, that concludes my

cross-examination.

EXAMINER PIRIK: Thank you.

Mr. Breitschwerdt.

MR. BREITSCHWERDT: No questions, your Honor.

EXAMINER PIRIK: Mr. Kurtz.

MR. KURTZ: Thank you, your Honor.

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CROSS-EXAMINATION

By Mr. Kurtz:

Q. Good afternoon, Doctor.

A. Good afternoon.

Q. I would like you to turn to page A8 of your testimony, it's your resume, your curriculum vitae, I guess.

A. If I have it. Yes.

Q. The second to the last item, in June of 2008, you testified at FERC regarding an incentive cost to capital for transmission investments by Virginia Electric Power. Do you see that?

A. I do.

Q. What was the -- what was the ultimate rate of return you testified to in that proceeding? Do you remember?

And I assume we are talking about the

20 rate of return on equity; is that correct?

21 A. Yeah. I'm trying to remember. I

22 believe -- well, first of all, this proceeding that

23 you identified is a proceeding in which the

24 transmission-owning company, this is Dominion, goes

25 to the regulator and asks for a premium rate of

return of up to 150 basis points over its baseline rate of return.

And the specific question that I answered was whether or not 150 basis points add or fell within what the FERC calls a range of reasonableness which is the highest and the lowest numbers that the sample comes up with.

And so in this particular case, I provided a range, and I don't remember what the top of the range was, but the baseline ROE for the company, I believe, was 11.4 percent to which was added 150 basis points to get you 12.9.

Q. And what's the purpose of the incentive in that proceeding? Incentivize the company to do what?

A. There's been a recognition, it's certainly by the FERC and I think by Congress as well, that investment in the transmission system had lagged behind what was necessary to provide the kind

20 of interconnection between generators necessary to

21 support deregulation or to even support the idea of

22 being able to reduce the cost of generation by taking

23 advantage of timing differences and so forth.

24 And so in order to get the transmission

25 lines built, the FERC believed that it would be

appropriate to give an incentive, an ROE incentive, to help them acquire the money necessary to make the capital investments and to overcome the obstacles necessary to build new transmission lines.

Q. Are you aware that witnesses in this case with respect to the significantly excessive earnings test, including Staff Witness Cahaan and OEG Witness King, applied a methodology where they developed a baseline rate of return and then applied a premium on top of it similar to what you just described?

A. I'm aware that that's been proposed. I don't agree that's a reasonable approach.

Q. Turn to page A7 of your exhibit. Fourth from the top is the -- are these the distribution rate cases of the applicants here? Toledo Edison, CEI, and Ohio Edison?

A. Yes, I believe that's the ones.

Q. Okay. Do you remember what your recommended rate of return on equity for those

20 utilities was or at least a range?

21 A. I don't remember exactly. I know there

22 was -- capital structure was 4951 and I think it was

23 11 percent or something like that. I don't remember.

24 Q. Let's use 11 percent, just for example

25 purposes.

The example that you calculated here using a 2007 sample year and using a 49 percent equity capitalization was the 19.88 percent or corrected 19.82?

A. Yes.

Q. Okay. So the difference between 19.82 and 11 percent, would you agree, is 8.82 percent return on equity?

A. Subject to check, I would.

Q. Have you calculated what 1 percent return equity equals in terms of revenue requirement to the customers?

A. No, sir, I haven't.

Q. Did you review the testimony of OEG Witness Mr. Collin where he made those calculations in this proceeding?

A. I read his testimony, but I focused on some other aspects of it.

Q. Let's assume for purposes of this

20 question, then, 1 percent return on equity for the

21 three utilities combined equals a revenue requirement

22 of $61 million.

23 Would you agree that the difference

24 between the 11 percent and the example of 19.82,

25 which the 8.82 percent times 61 million, I will do

the math, is $538 million of additional revenue requirements?

A. Is your calculation including income tax as well?

Q. Well, I am using the revenue requirement effect.

Now, that would not be the affect on net income. We would have to take out taxes but the revenue requirement affect would be $538 million?

A. Taxes plus net income or equity return?

Q. Yes.

A. I haven't done these calculations.

Q. Other than the passage of Senate Bill 221, has anything changed in the structure of these distribution utilities that in your mind would justify a revenue requirement increase of $538 million, for example?

A. The companies have -- to my knowledge have not filed for such revenue increase. What the

20 test is designed to do is to say ex post how did

21 things turn out?

22 I mean, obviously we are not setting

23 rates based upon a 19.84 rate of return or 82 or any

24 other number. What we are saying is ex post if

25 things went much better than expected for some

reason, we need to refund some money to the ratepayers. Well, they are not going forward with that recommendation.

Q. Fair enough.

Let me ask you this question, are you familiar with any recommendations from the company to exclude certain items of revenue from the excessive earnings -- substantial excessive earnings test?

A. I've heard of one, I believe, and there's some sort of an incentive payment for excellent performance.

Q. Or the distribution incentive rider?

A. Yes.

Q. Let me ask, you have reviewed the statute, I think that's been established, correct?

A. I didn't read every word. I focused on the part of excessive earnings test.

Q. Are you aware that these distribution utilities, because they do not own generation, would

not be entitled to this significantly --

substantial -- significantly excessive earnings test

if they were in an MRO rather than an ESP? Are you

aware of that distinction?

A. That almost sounds like a legal issue to

me and I have no opinion whatsoever.

Q. Well, assume in an MRO that these utilities don't own generation would only get the just and reasonable rate of return you believe was 11 percent in the prior case.

And in an ESP they would be entitled to earn up to this significantly excessive level, for example, 18 percent.

Assuming those subfacts, wouldn't that be an incentive for the utilities to choose an ESP rather than an MRO?

A. Well, a bit of a long-winded answer, I think, to your question.

First of all, the rates that are being set have some rate of return inherent in these rates and you wouldn't -- I won't expect that the company is going to be able to earn 18 or 19 percent very often.

That's going to be an extraordinarily, significantly excessive earnings if they got up that

20 high. And it's not going to happen very often, I

21 wouldn't think.

22 So in a world in which you set rates of

23 return, you either earn more or you earn less,

24 depending on how things go, and in the MRO there's no

25 refund required, at least as the way you have set it

1 up there is no refund requirement, whereas, here
2 potentially there could be.
3 So I am not sure which one of those two
4 roles is preferable, plus you get to earn on the
5 generation assets you invested in here, they buy the
6 power and make, I presume, no additional earnings on
7 having purchased the power. It's simply a pass
8 through.
9 So it's a matter of decision of which one
10 of those two is preferable to the companies' point of
11 view.
12 I understand they have chosen, at least I
13 understand the testimony earlier this morning that
14 they chose the ESP plan because they believed it
15 would cost the customers less money than the
16 market-based rates.
17 MR. KURTZ: Thank you, your Honor, those
18 are all my questions.
19 EXAMINER PIRIK: Mr. Lavanga.

MR. LAVANGA: No questions.

EXAMINER PIRIK: Mr. Kurtz -- or Mr. Yurick?

MR. YURICK: I'll answer to anything. Thank you, your Honor. I appreciate it.

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CROSS-EXAMINATION

By Mr. Yurick:

Q. Dr. Vilbert, do you know the current return on equity for the three companies involved here?

EXAMINER PIRIK: Could you use the microphone, please? I don't know where it got to.

MR. YURICK: I'm sorry.

Q. Dr. Vilbert, could you tell me what the current return on equity for the three companies is.

A. I knew the answer to this about six months ago when we were in the other case. It's 10 something. 10.2 or something like that. I've forgot it.

Q. You don't know?

A. I don't remember.

Q. Did you not consider the companies' current return on equity, the current return on equity of the three companies important or relevant

20 in trying to determine what a significantly excessive

21 earnings would be?

22 A. The test is not set up -- the test by the

23 statute is not set up that way. It's set up to

24 compare the realized rate of return, not the allowed,

25 the realized -- the rate of return with the realized

rate of return of comparable risk companies.

So it's -- it's an element of what the realized rate of return will be, but it's irrelevant to the test.

Q. So your testimony is what the company is making now on its equity is irrelevant as to determining what a significantly excessive amount of earnings would be?

A. The allowed rate of return will -- is a big factor in what they will actually realize, but the significantly excessive earnings test doesn't talk about the allowed rate of return. It talks about what did they actually earn and you compare what they actually earned to a sample of comparable companies and so the allowed rate of return does not enter into that calculation.

Q. My question though, and I'm sorry if you answered it because I'm a little bit -- you are speaking in a statistics university level and I think

I am still at about 3rd grade, okay?

You don't consider it significant or relevant to compare the return on equity that your test would arrive at and what the companies' currently getting as far as a return on equity?

A. In developing the test that I put in my

1 testimony I --

2 Q. I will let -- I'm sorry, I will let you

3 explain, but is -- are you able to answer that

4 question yes or no?

5 A. The short answer is that parameter is not

6 a direct input into the statistically -- or the

7 significantly excessive earnings test as written in

8 the statute.

9 It's just not an input, it doesn't

10 affect -- excuse me, it does affect what the company

11 actually earns because it's the measure that you

12 start with to set rates. But it --

13 Q. I think that was my question. Okay. But

14 go ahead, I'm sorry.

15 A. It's what you set -- it's what you start

16 with to set rates, but the test is what did you

17 actually earn.

18 The test isn't what did you earn relative

19 to what you were allowed; it's what did you earn

20 relative to what everybody else did of a comparable

21 group of companies, and so your allowed rate of

22 return doesn't enter into that calculation.

23 Q. Well, let me put it this way, maybe I can

24 ask it this way, could you assume hypothetically for

25 the purposes of my question that the three companies

are now averaging 10 percent return on equity, can we do that?

A. Sure.

Q. And as I read your testimony what you are saying is that significantly excessive earnings would be 19.82 percent; is that correct?

A. Yes.

Q. It says 19.88 but then you corrected it in the errata to 19.82.

A. And that's based upon a comparison to the sample what those companies earned and the 1.2 standard deviation for both.

Q. So the 10 percent that they are currently earning you are saying doesn't enter into your consideration of substantially -- what's substantially excessive?

A. It enters only to the extent that it is the base level that enters into the revenue requirement for the company that sets the rates, and

20 then if there are -- if they are allowed 10, the

21 chances of them getting to 19.8 is pretty small, I

22 would say, but that's not what the test is saying you

23 should do.

24 The test says look at what they earn,

25 compare that to what comparable risk companies earn,

1 and make a judgment as to whether that number that
2 they actually earned is significantly excessive
3 compared to what the comparable companies earned.
4 There is no allowed rate of return on any of that.
5 Q. Well, I guess what my question is just
6 from a very simple perspective is if I look at a
7 company and they are making 10 percent return on
8 equity --
9 A. Allowed.
10 Q. -- allowed and then I look at your
11 testimony and I see 20 percent, it begs the question
12 isn't there some number between 10 and 20 percent
13 that would still be substantially success -- or
14 excessive?
15 I'm sorry, it's 100 percent, you know.
16 A. I understand your point.
17 So let me tell you when I first read the
18 statute, I thought of a test in which what you are
19 saying would be an element of the test.

20 You would say what did they earn, what

21 were they allowed. If that number is relatively

22 close, we don't need to bother with the next step of

23 doing this other bigger more complicated test, we're

24 all done.

25 And I would think on most cases you would

1 observe there a regulated company that earns pretty
2 close to what it's allowed; you would think that's
3 what regulation would do.
4 You wouldn't expect to earn too much more
5 or too much less, but reading the statute the
6 statute, you know, English is my first language and
7 only language, and I read the statute and I don't
8 read legal very well, but I read what I thought they
9 were trying to say.
10 They don't talk about allowed rate of
11 return, and they could have easily have put that in
12 had they wanted to measure it against the allowed
13 rate of return, but the statute doesn't say anything
14 about allowed rate of return. It talks about what
15 did you realize as your electric company and compare
16 it to the sample, no allowed rate of return.
17 Q. Again, I am just looking at it from if
18 you assume they are making 10 percent.
19 A. Your argument or your concern seems to be

then let me take the next step.

Q. If they are making 15 percent, that's, you know, a 50 percent increase, that seems like a lot.

A. I understand. And your question really is, it seems to me, where do we draw the line? And

that is a question that everybody has to wrestle with.

I used 1.28 standard deviations. If I had used one standard deviation as Professor Woolridge did, the number would have been smaller. If you had used a half a standard deviation, it would be smaller.

The question is where do you draw the line, keeping in mind that if you draw it closer to the mean of the sample companies, you result in the company failing the test more often.

And, right now, I have set it up so it fails on average about 10 percent of the time if you believe the sample companies are comparable.

You can make it fail 25 percent of the time or on average something more but that -- and that would have the affect of moving the threshold down towards the mean, but I chose 10.

One time out of 10 that the company would

20 be determined to have significantly excessive

21 earnings and that's where it's 19 as opposed to the

22 numbers you are suggesting of 15 or some other

23 number.

24 Q. Well, my question stated very probably

25 ridiculously simplistic terms, isn't there somewhere

1 south of 100 percent that we can draw that line?
2 I mean, you are addressing the question
3 of where do we draw that line. All I am suggesting
4 is could we draw that line somewhere south of
5 100 percent?
6 A. The short answer is the Commission can
7 draw the line where it deems is appropriate, and
8 certainly you can be less than 19.8.
9 But what I was trying to point out
10 earlier is there's tradeoffs here about where you
11 draw the line.
12 If you draw the line such that the
13 company is every other year refunding money but on
14 the other years when it under-earns it gets no money
15 back, it doesn't get a refund from the customers, the
16 result will be it will earn -- it will not earn its
17 cost of capital on average.
18 You also have incentive issues by making
19 them fail too much because you want the company to

20 have the incentive to go out and find ways to save

21 money because they get to keep the money in their

22 pocket if they can find ways to save, and the next

23 time you have a rate case you say, well, you were

24 able to find these nice cost savings, we will go to

25 pass these on to the customers now going forward.

If you cause them to fail this test every time they find cost savings, they don't have the incentive to find those cost savings as frequently going forward.

That is my fear, and so you could set this line lots of places, but there's tradeoffs both ways. If you set it too high, it's too strict. The ratepayers potentially pay more than they need to pay.

If you set it too low, you have the adverse affects I just mentioned a minute ago. I figured 1 time out of 10 is a reasonable measure, and that's based upon the sample.

Q. Okay. And your testimony, I think, as I understood it earlier, was in setting that line at 15 or 20 or wherever, you don't think what the company currently makes is an important consideration?

MR. KORKOSZ: I'll object, it's been asked and answered.

EXAMINER PIRIK: I agree. Sustained.

Q. I'll move on.

Switching to another topic of your testimony, you came up with a number of comparable business entities and my understanding of your testimony is that you considered these comparables

both in terms of financial risk and business risk; is that correct?

A. They are comparable in business risk, and then I adjust for differences in capital structure.

Q. Okay. The one -- one factor that I did not see that you considered, so I want to ask you if you did consider it, is the competitive environment in which these businesses operate. Is that something you considered?

A. No, not directly. To the extent that many of the companies are -- if not most of the companies are regulated utilities, that issue is part of that process of making a regulated utility.

Q. Well, let me ask you this, do you think if a company operates in a highly competitive environment, investors would require a higher or lower return on equity?

A. In general you would expect a more competitive environment to have a higher expected

20 rate of return.

21 Q. Could you turn to page 9 of your

22 testimony, please, sir. I am going to ask you about

23 the first question and answer on that. It's question

24 20 and answer 20.

25 And specifically you say "If such

1 profits" -- this is on line 4, "If such profits would
2 be classified by accounting rules as extraordinary or
3 nonrecurring items or otherwise nonrepresentative of
4 the utilities -- operations, then they should also be
5 excluded from the measure for the utility in order to
6 maintain comparable with the same sample," so I'm
7 with you there.
8 An example may be a large gain or loss
9 caused by nonregulatory actions such as the gain on
10 the sale of nonregulated assets."
11 So as I understand your testimony, if the
12 company were to sell a nonregulated asset and realize
13 gain, that gain would be subtracted from the return
14 on equity because it's nonrecurring or nonordinary;
15 is that right?
16 A. Yes, that's what I had in mind.
17 Q. And by the same token if a company were
18 to sell a nonregulatory asset at a loss, you would
19 add that loss back in to their return on equity

20 because, again, it's nonrecurring; is that right?

21 A. Yeah, I want these things to be

22 symmetrical.

23 Q. Well, that's my next question.

24 Do you know in real -- in real world

25 terms is it equally likely that a company would sell

a nonregulatory asset at a loss as it is likely that a company would sell a nonregulated asset at a gain?

That was inartfully stated. What I mean to say is is it equally likely that a company is going to sell a nonregulated asset whether it takes a loss or whether it realizes a gain in real world terms?

A. I would have answered your question differently a couple of weeks ago, but now with --

Q. Well, sorry. Here we are.

A. -- the market falling like it is, it's not clear to me that a sale would necessarily be at a gain going forward.

But the heart of your question is do I expect them to normally sell a nonregulated asset as a gain. I would say more than likely they would sell it at a profit. It could be the other way, however.

But keep in mind this is nonregulated, the ratepayers didn't pay for this. There is no

20 reason in the world they should benefit from its sale

21 or its loss.

22 Q. That's not really my point. I guess the

23 crux of my question is to the extent that it's not as

24 likely that a utility would sell a nonregulated asset

25 at a loss as it is likely that a utility would sell

1 at a gain, doesn't that create an asymmetry like you
2 talked about because it's more likely that you are
3 going to be subtracting return -- subtracting the
4 gain from a return on equity than it is likely that
5 you are going to be adding back in?
6 A. Maybe, but even if that were --
7 Q. Thank you, I got "maybe" out of you.
8 A. But even if it were true -- I will say
9 yes. Even if it were true, it shouldn't be part of
10 the test because you're trying to determine whether
11 the regulated company has significantly excessive
12 earnings.
13 The fact that some portion of the company
14 that's unregulated sold something that generated a
15 profit, why should that enter into these
16 calculations?
17 That's just a matter of principle as
18 opposed to the likelihood of the affect after the
19 adjustment.

MR. YURICK: I understand your answer. I am not sure I agree you with, but I appreciate your answer, and I have no further questions at this time.

EXAMINER PIRIK: Mr. McNamee.

MR. McNAMEE: I have no questions.

EXAMINER PIRIK: Mr. Korkosz.

MR. KORKOSZ: Your Honor, I recognize the hour but ask the Bench for a couple of minutes.

EXAMINER PIRIK: We will stay right here and await your return.

(Off the record.)

EXAMINER PIRIK: We will go back on the record.

Mr. Korkosz.

MR. KORKOSZ: Yes, your Honor, just a couple.

- - -

REDIRECT EXAMINATION

By Mr. Korkosz:

Q. Dr. Vilbert, there was some inquiry about your use and your testimony of the characterization windfall. Do you recall that?

A. I do.

Q. Did your choice of using that -- that word or thinking about it in those terms in any way

influence the methodology of -- the methodology you chose to implement the statutory test?

A. No. It was -- it was just an unfortunate choice of words. I think I should have not done that, but it didn't do anything other than be in that sentence.

Q. The other item, Dr. Vilbert, Mr. Kurtz brought up the subject of the FERC incentive adder for certain transmission projects in your testimony there. Do you recall that?

A. I do.

Q. And he asked, I think, if you agreed with the use of the -- that incentive adder in determining the measure of what is -- what is significantly excessive earnings for purposes of the test you were speaking about. Do you recall that?

A. I do.

Q. And my recollection is that you didn't agree with the use of that test in these circumstances, correct?

A. That's correct.

Q. Could you tell us why?

A. Well, first of all, the FERC sets this rate of return. The way they build it up they start with a base level of return. Then they add 50 basis

20 points for being a member of an RTO.

21 Then up to 150 basis points of incentive,

22 so we are already up to 200 basis points over the

23 rate of return they figure that you get from the

24 methodology that they use, but they allow it and

25 expect the company to earn it.

They don't require you to refund anything if you earn more than that. They actually expect that you will earn up to -- some of these companies have rates of return that have 13-1/2 to 15 percent ROE. And they expect them to earn that.

They clearly don't believe that's excessive because there is no need for a refund if they earn more than what's allowed, so this is -- my judgment a completely made up or inappropriate use of this -- this metric that the FERC uses to provide incentive to have transmission built in.

It has nothing to do with significantly excessive earnings. It has nothing to do with excessive earnings because no refund is necessary.

MR. KORKOSZ: I have nothing further.

EXAMINER PIRIK: Thank you.

OCC.

MS. ROBERTS: I have no further questions, thank you, Dr. Vilbert.

EXAMINER PIRIK: Mr. Sites.

MR. SITES: No questions, your Honor.

EXAMINER PIRIK: Mr. Porter.

MR. PORTER: No questions, your Honor.

EXAMINER PIRIK: Mr. Bell.

MR. BELL: Just one.

RECROSS-EXAMINATION

By Mr. Bell:

Q. If I understood your last response whether or not the company earns significantly excessive earnings is dependent upon whether or not its earnings are subject to refund? Did I understand your response correctly?

A. No, I don't think I said that. What I said was the use of the FERC incentive adder which envisions that the company would actually earn that amount of money or more with no possibility of a refund clearly is not indicative of excessive earnings according to the FERC, and so to use that measure here doesn't seem to be connected to anything as far as I can tell.

Q. To the extent that it is acknowledged to be an adder, does not that provide the companies subject to it with a cushion, if you will?

A. What do you mean by "cushion"?

Q. An earnings cushion above and beyond what they would otherwise be authorized to earn.

A. It means that their allowed rate of return is higher than it would be otherwise and the purpose of that extra money as I understand it is to provide building transmission -- standard is

1 extraordinarily different in the U.S. right now
2 because people don't want transmission lines in their
3 backyard and to overcome all of the obstacles to get
4 those things built which the FERC has decided as a
5 policy matter is important, they've authorized --
6 authorized these additional basis points to help the
7 companies go out to the market to get the capital
8 necessary to make these investments.
9 Q. So the ultimate objective is to assure
10 the companies' ability to access capital to meet
11 their perspective capital requirements?
12 A. That's a portion of it, yes.
13 Q. And is not that, in fact, one of the
14 underlying purposes of allowing the regulated
15 utilities in Ohio to earn excessive earnings as long
16 as those excessive earnings as measured by rate of
17 return do not become substantially excessive?
18 MR. KORKOSZ: I'm sorry, your Honor, I
19 have got to have that question reread.

20 MR. BELL: I thought it was clear.

21 (Record read.)

22 A. Regulation sets rates of return and

23 expects the company to have -- to earn more or less

24 over time.

25 They have established a test here that

1 says if you earn too much more, we are going to have
2 to refund, you know, the money to customers.
3 I don't know what to make of your
4 question about that there's incentive to have
5 excessive earnings because I don't think anybody in
6 this room, certainly, or the Commission is intending
7 for the company to have excessive earnings.
8 They are trying to set the rates, the
9 costs based upon what they actually believe them to
10 be. They've simply instituted a test to protect
11 ratepayers in the event that those estimations turn
12 out to be wrong. You know, I mean I don't -- I guess
13 I don't see where you are going with your question.
14 Q. The statute contemplates the companies'
15 earnings, excessive earnings, does it not, by
16 definition?
17 A. Yes. Well, it contemplates that if they
18 do, they should refund the money.
19 Q. No. They aren't required to refund the

money until those excessive earnings become substantially excessive.

MR. KORKOSZ: I object.

EXAMINER PIRIK: Objection sustained.

MR. BELL: I'm sorry?

EXAMINER PIRIK: Objection sustained.

Do you have a question?

Q. With respect to Ohio utility -- with respect to the utilities period, is it possible for utilities to continue in business if over an extended period of time they do not earn their cost to capital?

A. Yes. Sorry. I testified in California just a week ago, two weeks ago, American Water Company in California has failed to earn its allowed rate of return for the last 10 years, and it's a huge problem for them.

Their bond rates is falling. They can't get money in to make investment, it's a huge, huge problem, and so any regulatory system that has that result over a long period of time is inappropriate, should not be allowed, does not provide the ratepayers or the shareholders the proper support that they need.

MR. BELL: That's all I have. Thank you,

sir.

EXAMINER PIRIK: Commercial Group.

MS. WUNG: No questions, your Honor.

EXAMINER PIRIK: Mr. Rinebolt.

MR. RINEBOLT: No questions.

MS. McALISTER: No questions.

EXAMINER PIRIK: Mr. Smith.

MR. SMITH: No questions.

EXAMINER PIRIK: Mr. Petricoff.

MR. PETRICOFF: We didn't cross so no to recross.

EXAMINER PIRIK. OPEC.

MR. BREITSCHWERDT: No questions.

EXAMINER PIRIK: Nucor.

MR. LAVANGA: No questions.

EXAMINER PIRIK: Mr. Yurick.

MR. YURICK: No questions, your Honor.

EXAMINER PIRIK: Mr. McNamee.

MR. McNAMEE: Nothing for me, thank you.

EXAMINER PIRIK: Thank you very much.

MR. KORKOSZ: If your Honor please, I offer Company Exhibits Exhibit 8 and 8A.

EXAMINER PIRIK: How about 8B?

MR. KORKOSZ: I marked it really as a convenience since we seemed to be at issue during the

20 course of Consumers' Counsel inquiry, but I have no

21 intention of offering it.

22 EXAMINER PIRIK: I think in light of the

23 fact we did refer to it a couple of times, I think I

24 would like to have it in the record so that we at

25 least know what was being referred to.

MR. KORKOSZ: I have no objection to its admission.

EXAMINER PIRIK: Are there any objections to Company Exhibits 8, 8A, and 8B?

Hearing none, those exhibits shall be entered into the record.

(EXHIBITS ADMITTED INTO EVIDENCE.)

EXAMINER PIRIK: Now, with regard to OCC Exhibit 6, I believe that one never quite --

MS. ROBERTS: I am not moving it.

EXAMINER PIRIK: So it is not going to be admitted into the record.

We will go off the record.

(Discussion off the record.)

EXAMINER PIRIK: We will go back on the record and say we will take a break, and the parties will notify us when they are done.

(At 3:07 p.m. a lunch recess was taken until 4:25 p.m.)

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Friday Afternoon Session,

October 17, 2008.

- - -

EXAMINER PIRIK: We will go back on the record.

Mr. Korkosz.

MR. KORKOSZ: We call Mr. Wagner.

(Witness sworn.)

EXAMINER PIRIK: You may proceed.

- - -

HARVEY L. WAGNER

being first duly sworn, as prescribed by law, was examined and testified as follows:

DIRECT EXAMINATION

By Mr. Korkosz:

Q. Please state your name.

A. Harvey L. Wagner.

Q. By whom are you employed and what capacity?

20 A. FirstEnergy Service Company. I serve as

21 vice president, controller, and chief accounting

22 officer of FirstEnergy and its subsidiaries,

23 including the Ohio utility companies.

24 EXAMINER PIRIK: Can you pull the

25 microphone, yeah.

Q. Do you have before you what has been a multi-page document that has been identified as Company Exhibit 2 and is styled the Direct Testimony of Harvey L. Wagner?

A. Yes.

Q. Is that your testimony in this proceeding?

A. Yes, it is.

Q. Mr. Wagner, are you aware that there has been a list of errata items marked for identification in this proceeding as Company's Exhibit 10?

A. Yes.

Q. And you've seen that document?

A. I have seen the document.

Q. Several of the errata items are associated with your testimony or schedules that you sponsor. Is it your intention those errata be adopted into your testimony?

A. Yes, it is.

Q. Other than those items are there any addition -- other additions or corrections to be made to your testimony?

A. I have one addition to my testimony, Exhibit 2, on page 8.

MR. SMALL: If you could slow down for

just a second.

THE WITNESS: Sure. It's page 8, line 17.

MR. SMALL: We are on your testimony.

THE WITNESS: Yes. Line 17, toward the end of that sentence it says "that relates to extended RTC," to insert before extended RTC. So that it reads "increased by the average amount of the write-off that relates to RTC, an extended RTC."

Q. Any others?

A. That's it.

Q. Subject to the errata and the correction you just made, if I were to ask you the questions today in Company Exhibit 2, would your answers be the same?

A. Yes, they would.

MR. KORKOSZ: Mr. Wagner is available.

EXAMINER PIRIK: Mr. Lavanga.

MR. SMALL: Your Honor, I do have motions

to strike.

EXAMINER PIRIK: Okay. Mr. Small.

MR. SMALL: All of these motions to strike are based on the Bench's ruling that distribution matters would be handled in the distribution case.

My first page where this appears is on page 2, lines 21 through 23, and for OCC's purposes with the exception of the mention of line extensions.

The RCP distribution deferrals or matter ETP transition taxes and the items shown there at the bottom of page 2 are all matters that are pending in the distribution case 07-551.

EXAMINER PIRIK: Mr. Korkosz.

MR. KORKOSZ: Are we doing this one by one or does he have more?

EXAMINER PIRIK: How many do you have, Mr. Small?

MR. SMALL: I have many.

EXAMINER PIRIK: Why don't we go through all of them because I am thinking they are related.

MR. SMALL: Yes, they are related to one another.

Page 3, lines 8 through 10. Again, this is RCP ETP transition tax, and also line 9 is the --

is the DSM which is also a matter taken up in the distribution case.

Page 5, lines 5 through 22, the question and answer that appears towards the bottom of that page.

EXAMINER PRICE: Can I have those line

numbers again, please?

MR. SMALL: Lines 5 through 22, that question and answer that takes up most of the page. This again is discussion of the same matters. Transmission taxes, distribution costs.

EXAMINER PRICE: Mr. Small?

MR. SMALL: Yes.

EXAMINER PRICE: Some of the distribution deferrals from the RCP plan extend beyond the test year; is that correct?

MR. SMALL: Yes, I realize that and this is the difficulty. The companies' position in the distribution case was that although they extended beyond the test year and it would be fine if the company took the position as the staff did, as the OCC did, that you have to respect the test years, that was not the position of the company in the distribution case.

They wanted the companies' position as

20 it's filed and as it's pending before the Commission

21 in brief is that, for instance, let's take a concrete

22 sample, the RCP deferrals should be collected in the

23 first rate case and that it has nothing to do with

24 the date certain amount.

25 So if you decide the matter in the rate

case, the companies' position is that there are --
you don't have any carryover to another rate case.
EXAMINER PRICE: But on the other hand,
if we decide the rate case the way you are advocating
and rule in your favor on this motion to strike, the
company would be out of luck.
MR. SMALL: No, it would be carried over
to the next rate case. And here -- and here is my
predicament.
EXAMINER PIRIK: Mr. Small, why don't we
get all the motions to strike and then we'll have the
argument, because I'm thinking it will go over more
than one. Do you have any more?
MR. SMALL: Just trying to be responsive
to the Bench.
EXAMINER PRICE: That was my fault.
EXAMINER PIRIK: No, no. Questions that
are going to need to be answered.
MR. SMALL: Page 9, the question and

20 answer -- the question that starts on line 14 and the

21 entire answer which carries over to the top of page

22 11 through line 4, and then again line 6 through 10,

23 and 12 through 18.

24 MR. KORKOSZ: I'm sorry, you are losing

25 me, Mr. Small.

MR. SMALL: Well, it's the entirety starting on page 9, line 14, through page 11, line 18.

MR. LANG: So the discussion of 6B, 6C, and 6D.

MR. SMALL: Yes, consistent with my marking those same items on page 3. And then at the end, page 16, lines 5 and 6, that bullet point, and then 7 through 11, second bullet point.

ATTORNEY EXAMINER: Can I have that one again, please?

MR. SMALL: 5 through 11, lines 5 through 11 on page 16, the first two bullet points.

EXAMINER PRICE: And then the last two bullet points?

MR. SMALL: I'm sorry, that's the end.

EXAMINER PRICE: I'm sorry.

EXAMINER PIRIK: Okay. Now, with keeping in mind what the Examiner just questioned you, would

20 you please go through each one and explain?

21 MR. SMALL: Well, I think they are all

22 related to one another and I understand the matter of

23 the deferrals, but the predicament that the OCC and

24 other parties, intevenors are in the predicament that

25 was prescribed in the OCC's motion which was if we

1 are to discuss on brief RCP deferrals, the extensive
2 record on that issue of what -- whether they should
3 be granted at all and under what methods and so forth
4 is all found in the distribution rate cases, and that
5 was the fundamental purpose for having OCC's motion
6 which was to decide those matters in the distribution
7 rate case or in the alternative allow the OCC and
8 other parties to rely on the extensive record in the
9 distribution rate case.
10 Now, if we take the approach of just
11 dealing with the matters that were date certain in
12 the distribution case, then we have -- now we have a
13 partial, you know, the carryover, the deferral, we
14 have a discussion of that by the company.
15 And what they are asking for in that, and
16 I have no record whatsoever as far as they are just
17 showing the deferred amounts, but there's no
18 discussion in the record about how will you arrive at
19 these numbers, whether they are valid or not, whether

20 they are theoretically correct,

21 There is an extensive record in the

22 distribution rate case put on by other parties,

23 including the staff, which is just empty right now.

24 So all we have is a bunch of calculations

25 where we have no basis for how those calculations

1 were done or whether they are sound from a policy
2 standpoint.
3 MR. KORKOSZ: Well, a couple of things.
4 First of all, these -- this testimony and the -- what
5 is here is in support of an ESP plan which is not
6 something that can be decided in its totality in the
7 distribution case based on its record.
8 And the testimony here and particularly
9 the sections that are identified are in support of
10 various aspects of the ESP plan that are here.
11 Now, it is now, of course, that many of
12 the areas that are identified here deal with
13 deferrals which were the underlying rationale and
14 accounting, proper accounting treatment were
15 discussed at length by witnesses in the distribution
16 case.
17 I would note two points; first, since the
18 applicant does have the burden of proof in this case
19 to support its own plan, we feel it's important to be

20 able to have the schedules and the testimony of

21 Mr. Wagner in support of the provisions that are in

22 this ESP plan.

23 However, addressing I think the concern

24 and the rationale behind the Bench's directive first

25 discussed last Friday at the prehearing and then put

1 on the record yesterday, which was in part that any
2 evidence which is repetitive or duplicative or
3 otherwise covered in the distribution rate case would
4 not be admitted in this proceeding, in the interest
5 of administrative efficiency I would suggest that to
6 the extent that Mr. Wagner has identified schedules,
7 demonstrated how calculations are done and explained
8 that, that we are not replowing the ground of the
9 distribution case on the merits of the arguments and
10 the issues that were laid out there.
11 This is in support of how the
12 calculations are done and I would subscribe to the
13 thought engendered in the questions that Mr. -- that
14 the Bench rendered to Mr. Small that focused on the
15 fact that there are indeed post test year aspects,
16 post date certain balances and aspects to this and
17 there is no -- you know, while there was a -- a
18 discussion and argument and briefing of those issues
19 in the course of the distribution case, we have no

20 resolution yet and, you know, very simply if there is

21 a limitation of the recovery and the addressing of

22 those issues that stops dead at a date certain

23 effective in the distribution case, then we don't

24 have the record in this case where the motions to be

25 successful to be able to -- to sustain what I view is

1 our burden of proof in support of the plan provisions
2 that we have.
3 I think that in a careful look at the
4 portions of the testimony of Mr. Wagner that
5 Mr. Small has identified, I think we are not in
6 danger of the concern that the Bench had in terms of
7 administrative efficiency.
8 We are not looking to reargue the
9 rationale behind the positions taken by the parties
10 in the distribution case. We are simply identifying
11 here is how a calculation was made and here are the
12 workpapers and the results of that calculation in
13 support of our plan.
14 EXAMINER PIRIK: Motion to strike is
15 denied for all areas.
16 MR. SMALL: With that in mind, OCC would
17 like to renew its motion or make it anew, I guess,
18 under these circumstances the OCC made its motion for
19 administrative leave of the record in the electric

20 distribution case with the idea that we would have

21 that record to rely upon if the matters were not

22 decided in the distribution case.

23 Of course, we thought that the -- these

24 matters would be handled in the distribution case and

25 so we didn't need the alternative, but since we have

no testimony that we would like to rely on or to argue in this case in addition to granting the OCC's motion to deal with distribution matters in the distribution case, we would like to have -- or I move to take administrative notice of the record in the distribution case so that we can argue against some of the things they put in their plan here.

EXAMINER PRICE: Again, just with your motion to strike you seem to be making a really broad motion when perhaps a much more focused motion might make more sense.

Do you have specific -- let me finish, Mr. Small.

Do you have specific documents or schedules or pieces of testimony that you would like to take administrative notice of versus the entire dereg record?

The entire distribution case record is a huge record and that seems to be unreasonable to

20 incorporate that into this case. If you have got

21 specific pieces of testimony, specific schedules,

22 that's a different story altogether.

23 MR. SMALL: Well, I guess the problem

24 would be, and, no, we don't need the entire record.

25 I guess the problem is most records are interrelated

1 and pieces relate to one another.

2 The primary piece of evidence that OCC is

3 concerned about is we would like to rely upon the

4 testimony of Mr. Effron, who was our principle

5 witness on these matters that I've -- were the

6 subject of my motion to strike.

7 The problem with just having a reference

8 to Mr. Effron's testimony is that, of course, he

9 refers to other things in the record, you know, in

10 particular the testimony of other people and the --

11 and the exhibits or the Application and its

12 supporting documentation.

13 So it would be Mr. Effron's testimony,

14 and those things that are referred to and relied upon

15 in his testimony. Those -- that's the portion of the

16 record that -- that we think is missing by proceeding

17 in this case on distribution matters.

18 EXAMINER PIRIK: Well, as the Examiner

19 asked, do you have -- specifically have you gone

20 through his testimony and made a list of those things

21 that he refers to so that we can somehow quantify

22 exactly what you are asking for?

23 MR. SMALL: Well, in -- because of the

24 circumstances with being informed last Friday that

25 our motion was going to be granted, no, I haven't

1 undertaken that. That task could be undertaken and
2 could be presented to the Bench on Monday.
3 EXAMINER PIRIK: Mr. Korkosz.
4 MR. KORKOSZ: I don't particularly have
5 an objection to that procedure, but I would request
6 that we have an opportunity to review what Mr. Small
7 is proposing to add and have the opportunity to
8 comment or perhaps supplement in order to have a
9 complete capture of a full record on whatever issue
10 it is he is wishing to support.
11 EXAMINER PIRIK: I would say to the
12 extent the parties can get together and have a
13 discussion over what Mr. Small is proposing and come
14 to an agreement on limiting it, specifically to those
15 items which refer to Mr. Effron's testimony in the
16 distribution rate case, I think that would be
17 appropriate.
18 The Bench would prefer that you come to
19 us with a finite list of those items that you are

20 asking for administrative notice of.

21 MR. SMALL: It would seem as though the

22 ball is in my court for the first, so I would

23 endeavor to put together such a list by Monday

24 morning and I would bring it with me.

25 I could electronically send it to the

company and not having a ruling on Monday but perhaps on another day, like Tuesday or something like that, by Tuesday or Wednesday. I think we could have the discourse you are suggesting.

EXAMINER PIRIK: I think that's reasonable. Thank you.

Mr. Lavanga, did you already say you did not have any?

MR. LAVANGA: No questions, your Honor.

EXAMINER PIRIK: Okay.

MR. LAVANGA: Thank you.

EXAMINER PIRIK: Ms. McAlister.

MS. McALISTER: Thank you, your Honor.

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CROSS-EXAMINATION

By Ms. McAlister:

Q. Lisa McAlister on behalf of Industrial Users of Ohio.

I would like to turn your attention to

20 page 13 of your testimony. There you briefly

21 describe how the storm damage expense that exceeds

22 13.9 million annually from 2009 through 2013 will be

23 deferred.

24 There's no provision in this plan to

25 address the storm damage expenses that the company

has incurred as a result of last Monday's windstorm, is there?

A. No, there is not.

Q. So those expenses will not reduce the $13.9 million contemplated in this plan but may be the subject of a separate proceeding?

A. This particular part of the testimony relates to storm expenses subsequent to January 1, 2009.

Q. FirstEnergy hasn't factored into the base generations any amount for the tax deduction that producers of electricity such as FirstEnergy Solutions receives against federal income taxes for the production of electricity; is that correct?

A. We have made no specific adjustment.

Q. But at page 14 of the Application FirstEnergy indicates during the duration of the ESP generation charges will be adjusted to pass on to SSO customers the costs of new taxes among other items;

is that correct?

A. I don't have the Application open but my recollection is that that's part of a group of costs to the extent that they exceed $50 million.

MS. McALISTER: Thank you, Mr. Wagner, I have no further questions.

CROSS-EXAMINATION

By Mr. Smith:

Q. Good afternoon. ESP -- this is Attachment H which is the significant excess earnings mechanism that you propose adoption in this case. Do you have it in front of you?

A. I do.

Q. Okay. Isn't it a fact that Attachment H resulted from the expert testimony of Mr. -- Dr. Vilbert that was presented this afternoon?

EXAMINER PIRIK: Yes, can you grab the microphone. Mr. Small.

A. I didn't hear the first part of the question.

Q. Thank you, I will just repeat it.

Dr. Vilbert testified today about his theory on significant excess earnings test.

Were you here when he was testifying?

A. I was present.

20 Q. Okay. And the Attachment H in the ESP,

21 do you have it in front of you?

22 A. I do.

23 Q. Now, paragraph 1 would have addressed the

24 testimony or the presentment of Dr. Vilbert, would

25 that be correct?

A. That's correct.

Q. Okay. Now, paragraph II I guess it is, that would be the area you are responsible for?

A. That's correct.

Q. Okay. And if the Commission rejects Attachment H in the ESP, is it not true that the adjustments that you are proposing in your testimony to implement the earnings test no long -- would no longer apply?

A. If the Commission rejected Attachment H, it would significantly change our electric security plan that we filed. I don't know if that would be acceptable to the company.

I don't know that the the ESP would be implemented, therefore, I don't know if we would have an MRO and if the significantly excessive earnings test would even be relevant.

Q. Okay. Turning to page 6 of your testimony, you refer to paragraph A.7.d. of the ESP,

20 and as I understand your testimony, what you are

21 doing is for the excess earnings test you are further

22 adjusting your regulatory books that you keep for the

23 operating companies; is that correct?

24 A. Yes.

25 Q. And you are making changes to normalize

the accounting entries in order to apply the test?

A. If you would just give me a moment, I would like to look at paragraph A.7.d. of the Application.

Q. That's fine.

A. Okay, and I'm sorry, your question?

Q. Perhaps it could be reread, please.

(Record read.)

A. Yes. And those are as stated on section II on Attachment H.

Q. And in deciding which items should be adjusted, what is your criteria for making those adjustments?

A. The adjustments that I suggested are for things like equity and earnings of subsidiaries that are not related in any way to the distribution of electricity in Ohio.

For example, Ohio Edison has a wholly-owned electric utility subsidiary that does

business in Pennsylvania.

Q. Okay. Those are the examples you had in your testimony.

A. Right.

Q. But then you have another example concerning regulatory asset write down for CEI?

A. Yes. As part of our plan that we have filed as you know, we've -- that closes the waiver of recovery of RTC, extended RTC charges after January 1, 2009 which would result in the write-off of CEI's unrecovered transition costs and deferred shopping incentives as of December 31, 2008.

Q. So that adjustment does not concern separating distribution, nondistribution activities? It has more to do with representing financial statements in your adjusted regulatory books; is that right?

A. What it's meant to do is to remove the distorted -- the distortive affect of a significant nonrecurring item from the calculation.

Q. Okay. Now, you have a number of deferrals presented in your testimony. Some of them came from the rate certainty plan; is that correct?

A. That's correct.

Q. Now, you are not changing the terms,

20 conditions, of the rate certainty plan in --

21 undertaking these deferrals, are you, by restating

22 them in your ESP?

23 A. I'm not sure what you mean by "terms and

24 conditions of the rate certainty plan."

25 Q. Well, I can be more specific.

The rate certainty plan authorized the deferral.

A. That's correct.

Q. And also authorized a duration of recovery.

A. That is correct.

Q. Okay. By refiling it in the ESP case you are not making changes to those previously approved conditions, are you?

A. What was contemplated when the rate certainty plan was filed was recovery through the next distribution rate case of the deferrals that arose from the rate certainty plan in full.

All of the costs that were to be deferred through the period of time before the distribution rates would go into effect.

What was recommended by the staff in our distribution -- in our distribution case cut it off as of the date certainty in that case which left

20 subsequent deferrals hanging out there without a

21 means for recovery.

22 Therefore, they were folded into the

23 electric security plan as a means to achieve

24 recovery, but what the plan also does, since the

25 costs aren't recovered before January, 2011, is

extends the period when the carrying charges would be capitalized on the deferrals.

Q. Okay. In the RCP case that case authorized the deferrals, we agreed to that; is that correct?

A. That's correct.

Q. Just as foundation, but the actual rate recovery would not occur sometime in the future?

A. The -- as I recall, the order in the RCP case was specific that those costs would be recovered, the full amount of the deferrals would be recovered over a 25-year period. That's my recollection of what the Commission's order was in the case.

Q. That's correct, but also in that -- but in that case the rate -- the rate recognition for the deferrals was not approved.

A. It was not requested in that case nor was it approved, correct.

20 Q. In this case you are asking both

21 authority to defer but also authority to recover, are

22 you not?

23 A. That's correct.

24 Q. Now, is there any steps that you have

25 offered to make sure that costs being recovered are

1 reasonable and similar to what the undertakings you
2 agreed to in the RCP case in order -- do you want me
3 to go further or do you understand my question?
4 A. Well, let me answer it this way because
5 we are dealing with, for example, the distribution
6 deferrals from the RCP that were cut off as of the
7 date certain.
8 We continue and will continue to file
9 reports with the -- with the Commission on an annual
10 basis through the end of 2008 with respect to those
11 deferrals, so I think that same process remains in
12 place.
13 Perhaps your question goes to the
14 carrying charges, and that's a very straightforward
15 calculation.
16 Q. Okay. But most of the -- most of the
17 rate recognized recovery of these deferrals in the
18 ESP case does not involve some sort of process of
19 review.

20 A. As far as I know, there has been nothing

21 put in place for a process for review.

22 Q. Now, as far as trading a security out of

23 the deferral, can you describe the process of

24 securitization?

25 A. I can give you my --

Q. Previously?

A. -- my layman's understanding of what securitization is.

Mr. Blank is more intimately familiar with that process. But basically what it requires is to have the deferred costs, in this case the deferred generation costs or the phase-in generation credits to be specifically earmarked separately by the regulator, the PUCO in this case, is being recovered through a separate securitization bond charge which means that those costs can be used as a basis to go out and do financing in advance.

It's almost like the utility is getting recovery on a prepayment basis, let's say being able to monetize that regulatory asset.

But the recoverability is at a much greater probability factor because of all the protections that would be involved with the regulatory decision by having securitization bond

20 charge more or less guaranteed as being recoverable

21 from customers.

22 Q. Okay. And does a securitized bond charge

23 stay on the books of the company or do you sell it?

24 A. No. It would remain on the company's

25 books, and typically what's achieved by this is a

lower financing cost because the rate of default would be so much lower, the risk of default would be so much lower.

MR. SMITH: I appreciate your time. Thank you.

EXAMINER PRICE: Mr. Wagner?

THE WITNESS: Yes, sir.

EXAMINER PRICE: In light of recent developments in -- across the country, is the company's securitization proposal still even remotely possible?

THE WITNESS: I believe so. The cost of it may be a little different than we would have originally anticipated depending on where the markets are whenever the financing is done. But I believe it is.

EXAMINER PIRIK: I think we will keep going in this direction, if that's fine.

MR. SMALL: I think we are going to

finish the witness today, so that's fine.

EXAMINER PIRIK: Mr. Petricoff.

- - -

CROSS-EXAMINATION

By Mr. Petricoff:

Q. Good afternoon.

A. Almost evening.

Q. Almost evening, right.

In Mr. Warvell's testimony he indicated in 2009 the company would be deferring the generation charges of 49 million in 2010, 550 million -- I'm sorry 2000 -- let me start from the beginning.

Mr. Warvell indicated the company would be deferring $230 million in 2009, $490 million in 2010, and $550 million in 2011. And then he indicated on page 9, line 16, that the carrying charges would be the subject addressed by Mr. Wagner.

Are you that Mr. Wagner?

A. I am.

MR. PETRICOFF: Your Honor, I would like to have marked as an exhibit Competitive Suppliers No. 5.

EXAMINER PIRIK: The document will be so marked.

(EXHIBIT MARKED FOR IDENTIFICATION.)

20 Q. Mr. Wagner, when I looked through your
21 testimony in the Application, I could not find
22 anywhere where it was stated what the total interest
23 costs would be on these generation-related deferrals
24 if the program went to three years as anticipated on
25 the ESP plan.

Did I miss anything? Is there somewhere in your testimony where you have the sum total of what the -- what the interest would be?

A. There is not a sum total. There is a Schedule 6F that illustrates the interest -- it gets you pretty close but the assumption there is the deferrals happen evenly throughout the year which we know will not be the case because sales vary.

But the -- it illustrates the magnitude -- order of magnitude of the interest that would be associated with the deferrals on that schedule.

Q. And do you have a Schedule 6F with you?

A. Yes.

Q. And I think the one you are referring to then would be page 4 of 12?

A. For the three companies combined, that's correct.

Q. And I might add, although there are some

20 corrections in your errata sheet for Schedule 6F,

21 there are no changes to this sheet?

22 A. That's correct.

23 Q. Now, what I would like to do with you

24 now, and the sheet that I passed out as Competitive

25 Supplier's Exhibit No. 5 is just sort of a worksheet

where I went down through the schedule to try to come up with the sum total of the interest, and I want to go through the procedure with you to make sure that I -- that my method is correct.

But I'm not going to ask you to verify the numbers on the worksheet, and that's something that can be -- can be done later to see if I have correctly transferred the numbers from your sheet to my worksheet.

To begin with, what we are working on here in the -- during the ESP period of 2009, 2010, 2011 would be a monthly carrying charge of .70 -- .7083 percent; is that correct?

A. For the deferral period, that's correct.

Q. And annualized that comes out to about 8-1/2 percent?

A. Yes, it does.

Q. Just out of interest, what is the interest payment that the company makes on deposits

that a customer would make if a customer had to make a deposit with the company, what kind of interest do they get paid?

A. I can't tell you specifically what it is because the number I am remembering is old, but those things don't change a whole lot. My recollection

it's in the 6 percent range.

Q. And so basically what we see here on line 2 of Schedule 6F, page 4 of 12, you are applying this monthly charge to what we think the deferrals will be in the years, and moving across from column D, 2009 -- let's just start 2009, and that should be 18 million 893 -- $18,693,180?

A. That's correct.

Q. And for 2010 we would just move across the 60,834,117?

A. Yes.

Q. Okay. And then 2011 would be 24,096,347?

A. Yes.

Q. And because there is a delay in the collections, you would have to make up the rest of 2011 during 2012?

A. That's correct.

Q. And that would be roughly 51,700,576?

A. That's right.

20 Q. So during the ESP period then the

21 carrying costs would be about $154,631,220.

22 A. Assuming that is what that total is for

23 those four years, yes.

24 Q. Right. And also we are assuming that

25 basically the deferrals are taken readably every

month.

A. Right, right.

Q. And then that will take us out of the ESP period and then we have got 10 years in which we are going to collect interest on the balance that's going to be reduced as the -- I guess it's the DCG rider is collected?

A. That's correct.

Q. Okay. And if I look on your -- your schedule here, your Schedule B6F, page 4 of 12, I would find those in column F starting on line 32?

A. That's right, that's correct. The interest rate that's being used there is a lower rate. It would be based on the embedded cost of debt at the end of the, yeah, preceding the initial recovery.

Q. And that's about 6 percent?

A. It varies for the three companies. I think you could see that on page 1, 2, and 3 for each

20 company in the middle of the page.

21 It says line 31 for Ohio Edison, for

22 example, on page 1 estimated embedded costs of

23 long-term debt for the recovery of amounts that were

24 deferred in 2009 and 2010. That rate would be 6.53

25 percent, and then for the amounts that were deferred

in 2011 it would be 6.4.

Q. Now, we have two sets of year totals going through those that are proposed deferral recovery starting in 1-1-11 and then there's a -- I guess a subsection below it proposed deferral recovery starting in 1-1-13.

Why do we have these two different schedules, why are they bifurcated in this matter?

A. It's the way the plan was designed for the deferrals for the first two years were going to be recovered beginning in January of 2011. And then the deferrals for the year 2011 were isolated and it was designed to begin recovery in 2013.

Q. And so to -- once again, in search for the total interest charge for the -- for the three years what I would need to do then is to sum this net balance interest in column F first from lines 32 to 41 and then from lines 43 to 52?

A. That's correct.

Q. Okay. And assuming that I have done that correctly on my -- on my worksheet, then we are talking about roughly $217 million for the 1-1-11 portion of the plan and $136 million for the January 1, 2013 portion of the plan.

A. Again, assuming the math is correct,

that's right.

Q. Okay. So all together we are expecting then that the interest charge will be 508 million -- well, we will just say roughly $508 million for the period.

A. That's what it appears.

Q. Okay. And then when you go to collect this, you being the operating companies, you would be subject to the commercial activities tax?

A. As we already are, that's correct.

Q. Okay. And if I was going to -- and, of course, those charges would be passed through to the -- to the consumers in there -- in the DGC charge? Defer generation?

A. That will be passed through to customers in any circumstance, even if the fuel costs had not been deferred originally.

Q. And if I wanted to see what those are, the mechanics are the same, I would -- I would go to

20 what is now column D in schedule 6F, 4 of 12, and

21 first sum lines 32 to 40 and then sum lines 43 to 52?

22 A. I see them.

23 Q. Yeah. And assuming that I have done that

24 correctly, basically the grand total then of carrying

25 costs and the CAT tax would come to roughly $5

1 million.

2 A. That's a combination of those two things

3 but the CAT tax is not incremental to what would have

4 otherwise been paid had there not been a deferral,

5 which I think is where you are going with the

6 interest.

7 So if you are looking for just the

8 incremental CAT tax associated with the interest, you

9 would just apply the commercial activity tax rate to

10 the interest amounts, if that's what you are seeking.

11 Q. Okay. Then I am confused. What does the

12 CAT tax -- let's move specifically to column D, line

13 32, the 304,116.

14 A. Yes.

15 Q. Is that just the CAT tax on the interest

16 or is that the CAT tax on the whole revenue?

17 A. It's the CAT tax on the whole revenue,

18 and the reason that's on the schedule is because

19 since the CAT tax is being paid to the state of Ohio,

what we are recovering in fuel costs then or deferred fuel costs is a net of the revenue less the CAT taxes. That is what gets applied then to the deferral.

EXAMINER PRICE: Excuse me, you've said fuel costs twice now. We are not talking about fuel

costs.

THE WITNESS: It's deferred generation state, it was purchased power.

EXAMINER PRICE: I thought I was the one that was incorrect.

THE WITNESS: That's my old age. I grew up when there was generation in the operating companies, so I apologize.

Was that clear?

Q. Yes. Yes. That -- that helps us. We would have the CAT tax regardless of the deferral.

A. That's correct.

Q. So probably the better number then if we were looking to see what the impact of just the deferral would be, would be to look just at the -- at the interest column of $508 million?

A. That's essentially correct.

Q. Now, I notice that you -- you amended your testimony on page 8, line 17, to add RTC as well

20 as extended RTC to the -- to the calculation of the

21 excessive earnings test.

22 Can I take it then by this addition that

23 there will still be RTCs that have not been amortized

24 come January 1, 2009?

25 A. That's correct.

Q. And at this point in time can we say definitively on January 1, 2009, the only company of the three operating companies that will have RTC and extended RTC is Cleveland Electric Illuminating?

A. Yes.

Q. So that by waiving the RTC and extended RTC payments, the customers -- the only customers who will see a benefit will be Cleveland Electrical Illuminating customers?

A. Will only affect Cleveland Electric, that's correct.

Q. Just one last question, the amount that we have here for the write-off which I think you've listed on line 8 of -- I'm sorry, line 8 of page 8 is $485 million. And then afterwards you have in parens 306 million after taxes.

When the deferrals were made when the $485 million -- actually let me ask a prefatory question first

The $480 million, that's a projection of what the -- what will be in the RTC and extended RTC account on January 1, 2009?

A. That's correct.

Q. And that projected amount consists both of the -- the -- what had been deferred and taxes on

that deferral?

A. It just represents what has been deferred the 485 million.

Q. But when you made the deferral, was it grossed up to recognize income taxes? Gross receipts tax?

A. What you see on line 8 on page 8, the difference between the 485 million the 306 million is the deferred income tax impact of that that the 485 itself is before tax.

Q. All right.

A. Yes.

Q. But you've not paid the tax yet and by writing it off you will not have to pay the tax.

A. We will not have revenue on which to pay the tax, that's correct.

Q. And that accounts for the difference between the 485 and the 306?

A. That's correct.

MR. PETRICOFF: I have no further questions. Thank you, Mr. Wagner.

EXAMINER PIRIK: NOPEC.

MR. BREITSCHWERDT: No questions, your Honor.

EXAMINER PIRIK: Mr. Yurick.

MR. YURICK: No questions, thank you, your Honor.

EXAMINER PIRIK: OCC?

MR. SMALL: Yes, thank you. Let me find a microphone.

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CROSS-EXAMINATION

By Mr. Small:

Q. Thank you. Mr. Wagner, Jeff Small, OCC, I have a few questions for you this afternoon.

Would you please turn to Page 2, line 17 and 18 of your testimony.

A. Okay.

Q. And at this point we are on line 13 of your -- you state that you are sponsoring portions of the plan and you cite certain items in this table which I've directed your attention to on lines 17 through 18. You mentioned line extension costs, do you see that?

20 A. Yes.

21 Q. And you've done -- or you've -- you are

22 supporting the deferrals that are connected with

23 those line extension costs; is that correct?

24 A. That's correct.

25 Q. Let's assume that line extensions are

carried out pursuant to the Application in this case. Would there be any additional deferrals for line extensions?

A. If the approach that we took in the distribution case remains unchanged and the rules that are promulgated by the PUCO --

Q. That's the hypothetical.

A. That's correct.

-- there would be no further deferrals.

Q. Okay. Would you please turn your attention to Page 2, line 21. And here at this point you refer to deferrals RCP distribution. Do you see that?

A. Yes.

Q. Now, the distribution deferrals that you are referring to result from PUCO approval at least in part of a supplemental stipulation in Case 05-1125; is that correct?

A. That's RCP case, that's correct.

20 MR. SMALL: At this point I would like

21 OCC Exhibit 7 marked.

22 EXAMINER PIRIK: The document will be so

23 marked.

24 (EXHIBIT MARKED FOR IDENTIFICATION.)

25 Q. Mr. Wagner, you've seen what's been mark

as OCC Exhibit 7 before?

A. I believe so.

Q. And is this the supplemental stipulation that I referred to in my question and you referred to in your answer? The supplemental stipulation in 05-1125?

A. I don't remember a question and answer about it, I apologize.

Q. I'm simply asking where the RCP deferrals originated from this -- this docket and from this docket.

A. Okay. Yes.

Q. Okay. And would you please turn to page 13 of that document. Do you have that?

A. Yes.

Q. Okay. And we briefly went over this in your deposition. This is exactly the same -- or with the exception of the heading to these, page 13, this is the same document as your Attachment HLW-1 in your

20 testimony; is that correct?

21 A. That's correct.

22 Q. Okay. So the headings I am talking about

23 are in your testimony, you put the Attachment HLW-1

24 on the document, correct?

25 A. That's correct.

Q. And then the document page 13 that I am showing you, there is a heading on the document called "Capital"; is that correct?

A. That's correct.

Q. Okay. Now, is the heading on page 13 of the OCC Exhibit 7, that heading which says Capital, is that an appropriate heading for your H -- Attachment HLW-1?

In other words, the intention of your attachment to your testimony, these are only capital accounts?

A. Yes. I will refer you to page 4 of my testimony, lines 9 and 10, where it says "The companies request authorization to defer costs associated with distribution capital investments." And it goes on to say that those are listed on HLW-1.

Q. Okay.

A. So there is really no need to label it "Capital."

20 Q. I just wanted to make sure we had the

21 understanding this is the capital because on the

22 previous page, on OCC Exhibit 7, there is another

23 attachment and that's not for capital.

24 A. That's correct, that's correct.

25 Q. So your intention is to repeat the

1 material that's on page 13 of OCC Exhibit 7?

2 A. That's correct.

3 Q. Okay. And you wouldn't have a problem if

4 we put the title Capital on the top of your

5 Attachment HLW-1?

6 A. Not at all.

7 Q. That would be consistent with your

8 testimony.

9 A. Yes.

10 Q. All right. Would you please turn to page

11 4 of your testimony. Lines 22 through 23. And here

12 I refer you to a sentence the beginning "Of which

13 interest will be deferred monthly on the -- on the

14 amortized deferral balances."

15 Do you see that?

16 A. Yes.

17 Q. Now, here you are referring to the

18 balances that you are talking about are storm damage

19 costs, deferred line extension costs, deferred costs

20 associated with a distribution capital investments,

21 the matters that are discussed on lines 19 -- 17

22 through 19 of your testimony; is that correct?

23 A. That's correct.

24 Q. So FirstEnergy proposes to charge

25 interest on the gross additions to the plant, not net

additions to plant; is that correct?

A. I want to make it clear, it is gross additions net of depreciation as the depreciation accumulates on those additions that relate to Attachment HLW-1.

Q. Okay. I am not sure I am clear about that.

A. Okay.

Q. Let me go through an example and see if we understand one another.

A. Okay.

Q. In year one of the plan there are additions, capital additions to the plant, and we are talking about the distribution system, right?

A. Right.

Q. Okay. And there are subsequent additions in year two and year three. In year two do we have interest on the year one gross amounts or on year one gross amounts with the depreciation?

20 A. The post in-service interest is on the

21 net. The gross amount net of the depreciation that

22 was recorded in the first year.

23 Q. So it's on net plant additions, not

24 gross?

25 A. Yes. It's on the just gross additions

subsequent to January 1, 2009, and we wanted to make a distinction very carefully that it was not on all depreciation on pre-January 1, 2009, property.

That was an issue in our distribution case so that's why we made a very careful distinction. You can see it on the schedules.

Q. Please do so.

A. Okay.

Q. What schedules are we looking at?

A. I'll tell you when I find them.

It would be in Schedule 6I. If you go to page 8. Sorry, I'm in the middle of something with my eyes here so I can't see if I have my glasses on.

Q. Your company made the print plenty small enough.

A. So if you look on page 8 of 9 of Schedule 6I.

Q. Hang on for just a second.

All right.

20 It's a table saying "Stated Capital

21 Interest Calculation" at the top?

22 A. Right. If you look at line 6 -- first,

23 line 5 has the gross capital additions. Line 6 has

24 the depreciation associated with that.

25 And line 9 has the net plant and for the

first year when applying the interest, the post in-service interest, the base would be roughly half assuming the additions happen eventually throughout the year.

Q. You are not on this table any more, right, these are plants and now you are describing interest?

A. No. I am -- I am getting to the interest.

Q. Okay.

A. Okay? The base for the interest is the average net depreciated plant on those capital additions. And that's what you see on line 9, so just recapping, we have depreciation on line 6, that amount is reducing the base that we're calculating the interest on.

Q. Okay. And this -- just -- I think I have that.

A. Okay.

20 Q. On line 6 the depreciation that you are
21 showing there is just on additions, we are not
22 talking about anything that was already in place
23 beforehand.
24 A. That's correct, that's correct. So that
25 just walks down to the balance that's used as a base

for calculating the post in-service interest. And that is on line 9.

And then if you follow that through, applying the interest rate to that yields what you see on line 10. And then this balance just rolls forward.

You have in the next year on line 12 the capital additions and then you have depreciation on the full amount of the prior year additions at the accumulated balance which is net of depreciation.

Then you have the current year depreciation, and then a new net plant number, so all of -- all of these amounts that you're using to compute the base for calculating interest have been reduced by the depreciation associated with the capital.

MR. SMALL: I have no further questions.

EXAMINER PIRIK: Thank you.

Mr. Bell?

MR. BELL: Thank you.

- - -

CROSS-EXAMINATION

By Mr. Bell:

Q. I will try not to be repetitive, Mr. Wagner. I would like to first explore --

EXAMINER PIRIK: Could we pass the microphone over, I am sorry.

MR. BELL: I'm sorry, I didn't think I needed one.

EXAMINER PIRIK: Maybe it's just late in the day.

Q. I would first like to explore with you the nature of the proposed deferral recovery captured in the ESP plan as it is distinguishable from past deferrals, authorizations security from the Commission.

First of all, I think you had indicated in response to a question by Mr. Petricoff that in some past AAM cases before this Commission you have requested separately the deferred recognition of cost without net application seeking the defined recovery or recapture of that cost; is that correct?

A. That's correct.

Q. And as a result, the nature means the

20 duration, the amount to be recovered, the rate of

21 recovery as would be defined by the amortization

22 period would all be subject to future review by the

23 Commission, would it not? As evidenced by your

24 testimony in this case?

25 A. I'm not a legal expert but my

1 understanding is that all tariffs need to be approved
2 by the Commission, including the riders.
3 Q. Well, in this particular case -- strike
4 that.
5 In past deferral authorizations where the
6 Commission has reviewed deferrals in the context of a
7 rate case where it was establishing perspective
8 revenue entitlements of the company, has the
9 Commission, if you know adjusted previous deferrals?
10 A. I can recall back in the days when we had
11 a fuel clause, a fuel adjustment clause, and we had
12 to defer fuel -- I shouldn't say often but there were
13 instances where adjustments would have been made.
14 Q. So there was continuing oversight,
15 regulatory oversight, if you will, as to number one,
16 the appropriateness of the deferral in the first
17 place.
18 A. Yeah. The continuing oversight would
19 have been because the deferral would have been

20 continued to be accredited.

21 Q. Well, first of all, the Commission has to

22 determine, exercising its judgment, whether the

23 deferral should be recognized in the period in which

24 the cost is incurred or deferred for future recovery,

25 correct?

A. That's step one.

Q. That's step one. In order to do that does not that require the Commission to exercise its judgment to determine the appropriateness by the amount that is requested by the utility to be deferred for future collection or recovery?

A. The Commission has had that prerogative, certainly.

Q. And the Commission has in the past, has it not, on occasion said this is not appropriate for deferral because your current earnings will allow the expense to be recognized in the period in which the expense was incurred as opposed to deferring? It would not have a material impact upon your earnings, correct?

A. Is your question couched on step one or step two.

Q. Step one, whether it should be deferred in the first place or recognized in the year in which

20 the expense is incurred.

21 A. They certainly have that prerogative.

22 Q. And then step two is, is it not, if they

23 determine that the expense is reasonable in amount

24 and reasonably incurred, and subject to being

25 assigned to the customer's responsibility, then the

1 Commission has to determine how it's going to be
2 recovered, correct?
3 A. That's correct.
4 Q. And that is defining the period of the
5 amortization, correct?
6 A. They authorize the period of
7 amortization.
8 Q. And is the period of amortization of the
9 deferred expense often determined by the magnitude of
10 the deferred expense?
11 If it's a big, big expense, we have got
12 to spread it out over a longer period than a shorter
13 expense if, in fact, the expense is worthy of
14 deferral -- significant enough in the first place to
15 be worthy of deferral, correct?
16 A. I would say that would be an element in
17 the -- in the decision.
18 Q. And judgment is required to -- regulatory
19 judgment as well as oversight is reflected in those

20 determinations, are they not?

21 A. It's certainly an important element.

22 Q. Now, in the case at hand we're dealing

23 with RTCs which have not been recovered, correct, for

24 CEI?

25 A. That's correct.

Q. Now, with respect to the recovery, you were in the hearing room during my cross-examination of Dr. Vilbert, were you not?

A. Yes.

Q. Would you agree that if you write off an asset on the books of the company, you're telling the public, the accounting community investors, that you do not expect either the return of the asset, the depreciation, or a return on the asset via return on capital when that asset is written off; is that correct?

A. Not necessarily.

Q. In this case you address the adjustments for purposes of the excess -- for purposes of the deferrals, it's appropriate to put the deferrals back on the books, for instance, the RTC.

Does not the -- that accounting adjustment for purposes of the earnings to which the company may be entitled is to provide not for a

20 return of the asset via depreciation but yet the

21 potential return on the asset which the company is

22 already written off? Isn't that the affect of what

23 your proposal is?

24 A. No. The transition costs that would be

25 written off would represent just the costs that the

company has incurred that CEI incurred, that does not include any return.

Adding the amount of the after-tax write-off to the denominator of common equity reflects the fact that CEI will not recover those costs and will not earn a return on those costs.

One other thing that may not be clear is that we're talking about adjusting the 2009 and 2010 balances in the denominator being silent about the numerator because the assumption is that the write-off will be occurring in 2008, assuming that there is a decision about the ESP before we file our 10K for 2008.

If it were to be a 2009 event, the amount of that write-off $306 million would be added to the enumerator, would actually be added to the actual earnings of CEI in order to compute the return under the SB-221.

Q. Under traditional deferrals, Mr. Wagner,

would you agree that the Commission retains continuing oversight as to the appropriateness of the carrying charge to be perspectively applied to the deferrals during the period of the amortization?

A. The Commission authorized the initial amount, the initial carrying charge, so I would

1 assume that they would continue to have authority
2 over what's in the tariff.
3 Q. And they can adjust that from time to
4 time, can they not, and have, in fact, adjusted that
5 from time to time?
6 A. I don't know the law specifically to be
7 able to answer that.
8 Q. Well, if, in fact, the carrying charge is
9 tied to the cost of capital, when the Commission
10 makes a subsequent determination as to the companies'
11 cost of capital in a rate case following the
12 deferral, the Commission can change the carrying
13 charge rate, can they not?
14 A. That's correct.
15 Q. And they have, in fact, changed it in the
16 past, have they not?
17 A. The authorized rate of return has
18 changed, yes.
19 Q. The authorized return in terms of the

20 carrying charge, they have changed the carrying

21 charge, have they not, authorized carrying charge on

22 deferrals?

23 A. We have had regulatory asset deferrals

24 and recovery of several decades, and obviously the

25 cost of capital that has been authorized by the

1 Commission has changed over that time.

2 Q. And that change -- and those changes in

3 the cost of capital have been reflected in changes in

4 the carrying charges associated with the amortization

5 of deferrals, has it not?

6 A. To the extent that the regulatory asset

7 was included in rate base and the rate of return that

8 was applied to that rate base was different from the

9 prior rate case, that's absolutely correct.

10 Q. Now, do you, within the context of

11 this -- ESP proposal, propose essentially a constant

12 carrying charge rate?

13 A. Yes.

14 Q. So the Commission loses prospective

15 oversight to change the carrying charge rate to

16 reflect the then-applicable cost of capital?

17 A. I don't know the answer to that.

18 Q. We can, to the extent that you've got it

19 fixed, you are presuming that it's fixed throughout

20 the amortization period, are you not?

21 A. That's correct, but I can't presume to

22 know what authority the Commission has to make a

23 change to that in the future.

24 Q. I appreciate that, Mr. Wagner. You are

25 being very cooperative. I am not trying to be

1 argumentative. I am simply trying to point out to
2 the Bench and to the Commission what they might wish
3 to consider with respect to subsequent regulatory
4 oversight on the ESP plan as opposed to what you have
5 assumed in ESP plan, nothing more, nothing less.
6 With respect to the -- some of the
7 deferrals in your plan, some of which I think were
8 discussed by both Mr. Small and Mr. Petricoff, and I
9 will not retread their -- the path they so
10 beautifully constructed.
11 But is it a fact that with respect to a
12 number of the deferrals which you are proposing to
13 commence those deferrals are futuristic or
14 perspective? You are seeking current authorization
15 for future unknown costs, correct?
16 A. We are seeking authorization to defer
17 costs that under the plan we know we are going to
18 incur, not unlike other requests for deferral of
19 costs that we've made before the Commission.

20 Q. Fair enough. Would you agree that you
21 cannot today identify those costs in a fixed, known
22 and measurable fashion so that the Commission might
23 consider those attributes of the deferrals and
24 whether or not the Commission should authorize them?
25 MR. KORKOSZ: Objection. I don't think

there is a question there.

EXAMINER PIRIK: I believe there is a question. Go ahead and answer.

THE WITNESS: Can I hear the question again, please.

(Record read.)

A. I can't sit here today and say specifically to the dollar what those deferrals will be.

Q. We have no idea, do we, as to the magnitude?

A. We have a pretty good idea then we can forecast that, and I believe that's what Mr. Warvell has done.

Q. Storm damage costs to the extent that such costs exceed X. Now, how much is that exceeded looking forward to a future period of time, unless you are a better forecaster, sir, than the United States Weather Bureau in forecasting Ike's wind

damage here?

A. I am. I should be a meteorologist. No, I'm sorry, Mr. Bell. I was responding to the phase-in credits and that's what was in my head. I apologize.

Q. I'm not talking about phase-in. I'm

1 talking about the specific ones that I referenced.

2 A. I have no idea what those costs will be.

3 Q. Neither does the Commission, correct?

4 A. That's correct.

5 Q. Isn't that --

6 MR. KUTIK: On a second.

7 Q. Isn't that a blank check recovery, sir?

8 A. As I said before, when we have gone

9 before the Commission for authority to defer costs,

10 we in most cases don't know what the level of costs

11 will be that we are asking to defer.

12 We are asking to defer any costs in

13 excess of the amount that is included in our

14 distribution rates that will be in effect.

15 Q. That's what you were requesting in your

16 ESP.

17 A. That's correct.

18 Q. But in the traditional deferrals the

19 Commission has before it a fixed, known and

20 measurable idea what those costs are?

21 A. Well, I think back in the days of

22 deferred fuel, the Commission didn't know what our

23 fuel costs were going to be to the dollar.

24 Q. What about RTC? Those are fixed, known

25 and measurable, aren't they?

A. Yes, they are.

Q. So, in fact, they're so fixed, known and measurable, you rely upon them in your accounting, do you not, in reporting income as income?

A. No. AFDC has nothing to do with the RTC recovery.

Q. That's correct. That's on booking assets. Plant -- during construction work in progress. I agree with you, Mr. Wagner, and I departed for a moment.

Would you agree in any event in this case if you were requesting not only the deferral but the collection authority from this Commission for costs which are not now fixed, known and measurable and over which you are requesting the Commission give up regulatory oversight on carrying charges, on adjusting the amortization period of the deferral?

A. We've proposed an entire package with our ESP that has been designed to be beneficial to

20 customers compared to an MRO, as Mr. Blank has

21 described in his testimony.

22 In order to do that we have -- we have

23 made it very clear so that it isn't subject to

24 interpretation later exactly what the amortization

25 periods will be, exactly what the carrying charge

rates will be.

Q. Would you agree that with these deferrals mounting and mounting and mounting as they would as clearly reflected in the record that's been developed in these last several days, that the return that the company will be earning in booking in the future will be the profit of two business enterprises; one, the provision of electricity to its customers with its hardcore assets on which it's entitled to return and, two, it's return as a finance company to the extent of, as I understand it, you will be getting, if Mr. Petricoff's exhibit is accurate at all, $508,422,256 in interest carrying charge earnings on the loans?

A. Absolutely not. The three operating companies in Ohio will be earning a return on those deferrals at a rate below their costs of capital.

Q. In any event, you will be getting a return on the loans you made as well as on the

20 electricity sold to customers, will you not?

21 A. As I said, the carrying charge that would

22 be embedded in the rates during the recovery period

23 for those deferrals will -- the return will be lower

24 than the electric company's overall cost of capital.

25 MR. BELL: I think you've answered my

1 question. Thank you, Mr. Wagner. That's all I have.
2 EXAMINER PIRIK: Commercial.
3 MS. WUNG: Yes, your Honor. Thank you.
4 - - -
5 CROSS-EXAMINATION
6 By Ms. Wung:
7 Q. I think it's going on evening,
8 Mr. Wagner.
9 A. Yes.
10 Q. Mr. Wagner, my name is Grace Wung, I am
11 here on behalf of The Commercial Group. And I think
12 Mr. Petricoff already asked you this question, but
13 just so that I am clear, you are the witness
14 supporting the operating companies' request for
15 accounting authority related to deferred costs?
16 A. Yes.
17 Q. And in your testimony you are proposing
18 to accrue carrying costs on the deferred costs; is
19 that correct?

20 A. That's correct.

21 Q. Is your proposed carrying charge accrual

22 based on the net of deferred expense deferral or the

23 full deferral balance?

24 A. It is the full deferral balance.

25 Q. The full deferral balance. Is that --

that's on Schedule 6A?

A. Yes, that's correct.

Q. And if you were to accrue carrying charges on the net of deferred tax balance -- actually let me ask -- let me strike that.

Would accruing carrying charges on net of deferred tax balance lower the carrying charge amount?

A. It would lower the amount of the regulatory asset that would be recovered.

Q. That's a yes?

A. Yes.

Q. Thank you.

And if the operating companies are permitted to recover all deferral including carrying charges calculated on an -- on a net of deferred tax balance, would the operating company fully recover its deferred costs?

A. It would fully recover what had been

20 recorded, which would have been deficient from using

21 a net of tax balance in order to create the carrying

22 charge.

23 Q. And do you know for the carrying charge

24 through your proposal how much this carrying charge

25 results in?

A. Are you asking the total amount of carrying charges that will be deferred for all items that are included in the plan?

Q. Yes.

A. No, I don't have that.

MS. WUNG: Those are all of my questions. Thank you, Mr. Wagner.

THE WITNESS: Thank you.

EXAMINER PIRIK: Mr. Sites, do you have any questions?

MR. SITES: No questions, your Honor.

EXAMINER PIRIK: Mr. McNamee.

MR. McNAMEE: I do.

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CROSS-EXAMINATION

By Mr. McNamee:

Q. Good afternoon.

A. Good evening.

Q. Mr. Wagner, let's look at page 5 of your

testimony.

I will be done in about 2 minutes, by the way.

Do you have that?

A. Yes.

Q. Good. Thank you.

At lines 15 and 16 you refer to unamortized balances. Do you see that?

A. I see it, yes.

Q. Okay. Those unamortized balances consist of a lot of things, property taxes, depreciation, interest, all sorts of O and M expenses, right?

A. Yes.

Q. Okay. Now, those kinds of expenditures that the company makes are deductible for income tax purposes, aren't they?

A. They are.

Q. Okay. So the calculation of the companies' income taxes for the tax years when those expenditures are made are different as a result of making those expense -- those expenditures, aren't they?

A. Yes.

MR. McNAMEE: Thank you. We're done.

EXAMINER PIRIK: Mr. Korkosz, would

you --

MR. KORKOSZ: May we take a moment?

EXAMINER PIRIK: That will be fine. We will wait for you.

(Off the record.)

EXAMINER PIRIK: We will go back on the

record.

Mr. Korkosz.

MR. KORKOSZ: In the interest of meeting the Examiner's 6 o'clock performance target, we have no further questions.

EXAMINER PIRIK: Very good. Fifteen seconds to talk about exhibits then.

Mr. Korkosz.

MR. KORKOSZ: I offer Company's Exhibit 2.

EXAMINER PIRIK: Are there any objections?

Hearing none, Exhibit 2 shall be admitted.

OCC.

MR. SMALL: OCC moves OCC Exhibit 7.

EXAMINER PIRIK: Are there any objections?

Hearing none.

20 Before -- thank you very much,

21 Mr. Wagner. Before we move on to the next exhibit we

22 had been having -- we have been conferring up here,

23 we had cross purposes but we -- we believe that OCC

24 Exhibit 7, really we should take administrative

25 notice of that since it was filed in the Commission

1 docket.

2 MR. SMALL: That's fine.

3 EXAMINER PIRIK: Although we won't

4 recycle that number, we will note this administrative

5 notice of this document and the title of it.

6 Hearing no objection then, it is -- we

7 will take administrative notice of it.

8 Mr. Petricoff.

9 MR. PETRICOFF: Yes. I move to admit

10 into evidence Competitive Suppliers' Exhibit No. 5.

11 EXAMINER PIRIK: Any objections?

12 MR. KORKOSZ: Well, I have some

13 difficulty with it because at least a portion of the

14 calculations that are reflected on here were the

15 subject of some discussion. It was determined that

16 it actually wasn't representative of the fact. It

17 was -- well.

18 EXAMINER PIRIK: Mr. Petricoff.

19 MR. PETRICOFF: I think everything on

20 here is accurate. There is an agreement on the total

21 interest. There was an agreement on the total

22 interest and tax. There was discussion as to whether

23 the tax was incremental or not.

24 And I think the record will stand for

25 itself, but the numbers are fully explained and

there's nothing that has been shown to be improper with any of the numbers as of hearing.

EXAMINER PIRIK: Your objection will be noted, however, I think we went quite a ways in the record actually having that exhibit and discussing pieces of that exhibit. I think it would be hard at this point in time not to have it in the record, we wouldn't know what is really being reflected, so it will speak for itself and we will admit Competitive Suppliers' Exhibit No. 5 into the record.

(EXHIBITS ADMITTED INTO EVIDENCE.)

EXAMINER PIRIK: I believe those are the only ones we have for this evening. We are adjourned for this evening. We will reconvene Monday at 9 a.m.

Is there anything else we have to do on the record?

MR. KUTIK: Not on the record.

(The hearing was adjourned at 6:04 p.m.)

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1 CERTIFICATE

2 I do hereby certify that the foregoing is

3 a true and correct transcript of the proceedings

4 taken by me in this matter on Friday, October 17,

5 2008, and carefully compared with my original

6 stenographic notes.

7

8 _____

Karen Sue Gibson, Registered

9 Merit Reporter.

10 (KSG-4999)

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