BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

\- - -

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

\- - -

PROCEEDINGS

before Ms. Christine Pirik and Mr. Gregory Price, Attorney Examiners, at the Public Utilities Commission of Ohio, 180 East Broad Street, Room 11-C, Columbus, Ohio, called at 9:00 a.m. on Monday, October 20, 2008.

\- - -

VOLUME III

\- - -

ARMSTRONG & OKEY, INC.
185 South Fifth Street, Suite 101
Columbus, Ohio 43215-5201
(614) 224-9481 - (800) 223-9481
FAX - (614) 224-5724

\- - -

APPEARANCES:

FirstEnergy Corp.
By Mr. Arthur E. Korkosz,
Mr. Mark A. Hayden,
Ms. Ebony L. Miller
and Mr. James W. Burk
76 South Main Street
Akron, Ohio 44308

Jones Day
By Mr. David A. Kutik
North Point
901 Lakeside Avenue
Cleveland, Ohio 44114

Jones Day
By Mr. Mark A. Whitt
325 John H. McConnell Boulevard
Suite 600
Columbus, Ohio 43215

Calfee, Halter & Griswold, LLP
By Ms. Laura McBride,
Mr. James Lang
and Mr. Trevor Alexander
1400 KeyBank Center
800 Superior Lane
Cleveland, Ohio 44114

On behalf of the Applicants.

Janine L. Migden-Ostrander,
Ohio Consumers' Counsel
By Mr. Jeffrey Small,
Ms. Jacqueline Roberts,
Mr. Richard Reese,
and Mr. Greg Poulos
Assistant Consumers' Counsel
10 West Broad Street, 18th Floor
Columbus, Ohio 43215

On behalf of the Residential Consumers of the FirstEnergy Companies.

APPEARANCES: (Continued)

McNees, Wallace & Nurick, LLC
By Ms. Lisa McAlister
and Samuel C. Randazzo
Fifth Third Center, Suite 1700
21 East State Street
Columbus, Ohio 43215-4228

On behalf of the Industrial Energy Users-Ohio.

Chester, Willcox & Saxbe, LLP
By Mr. John Bentine,
Mr. Mark S. Yurick,
and Mr. Matthew S. White
65 East State Street, Suite 1000
Columbus, Ohio 43215

On behalf of The Kroger Company.

Brickfield, Burchette, Ritts & Stone, PC
By Mr. Michael K. Lavanga,
and Mr. Garrett A. Stone
1025 Thomas Jefferson Street N.W.
8th Floor, West Tower
Washington, DC 2007-5201

On behalf of the Nucor Steel Marion, Inc.

Ohio Partners for Affordable Energy
By Mr. David C. Rinebolt,
and Ms. Colleen Mooney
231 West Lima Street
P.O. Box 1793
Findlay, Ohio 45839-1793

On behalf of the Ohio Partners for Affordable Energy.

Constellation Energy Group, Inc.
By Ms. Cynthia A. Fonner
550 West Washington Street, Suite 300
Chicago, Illinois 60661

On behalf of Constellation Energy Commodity Group, Inc., and Constellation NewEnergy.

APPEARANCES: (Continued)

Vorys, Sater, Seymour and Pease, LLP
By Mr. Howard Petricoff
and Mr. Stephen M. Howard
52 East Gay Street
Columbus, Ohio

On behalf of Constellation NewEnergy, Inc., Constellation Energy Commodity Group, Direct Energy Services, and Integrys Energy Services, Ohio Association of School Business Officials, the Ohio School Board Association, and the Buckeye Association of School Administrators.

Boehm, Kurtz & Lowry
By Mr. Michael Kurtz
and Mr. David Boehm
36 East Seventh Street, Suite 1510
Cincinnati, Ohio 45202

On behalf of Ohio Energy Group.

McDermott, Will & Emery, LLP
By Ms. Grace C. Wung
600 Thirteenth Street, N.W.
Washington, DC 20005

On behalf of The Commercial Group.

Bricker & Eckler, LLP
Mr. E. Brett Breitschwerdt
100 South Third Street
Columbus, Ohio 43215

and

Bricker & Eckler, LLP
By Mr. Glenn S. Krassen
1375 East Ninth Street, Suite 1500
Cleveland, Ohio 44114

On behalf of Northeast Ohio Public Energy Council and the Ohio Schools Council.

APPEARANCES: (Continued)

Mr. Robert J. Triozzi
Cleveland City Hall
601 Lakeside Avenue, Room 206
Cleveland, Ohio 44114

Schottenstein, Zox & Dunn Co., LPA
By Mr. Gregory H. Dunn,
Mr. Christopher L. Miller,
and Mr. Andre T. Porter
250 West Street
Columbus, Ohio 43215

On behalf of the City of Cleveland and Association of Independent Colleges and Universities of Ohio.

Bailey Cavalieri, LLC
By Mr. Dane Stinson
10 West Broad Street, Suite 2100
Columbus, Ohio 43215

On behalf of FPL Energy Power Marketing, Inc., and Gexa Energy Holdings, LLC.

Bell & Royer Co., LPA
By Mr. Langdon D. Bell
33 South Grant Avenue
Columbus, Ohio 43215

On behalf of Ohio Manufacturers Association.

Bell & Royer Co., LPA
By Mr. Barth E. Royer
33 South Grant Avenue
Columbus, Ohio 43215

On behalf of Dominion Retail and the Ohio Environmental Council.

Ohio Hospital Association
By Mr. Richard L. Sites
155 East Broad Street, 15th Floor
Columbus, Ohio 43215

On behalf of Ohio Hospital Association.

APPEARANCES: (Continued)

Citizen Power
By Mr. Theodore S. Robinson
2121 Murray Avenue
Pittsburgh, Pennsylvania 15217

On behalf of Citizen Power.

Lucas County Assistant Prosecuting Attorney
By Mr. Lance Keiffer
2nd Floor
711 Adams
Toledo, Ohio 43624

On behalf of Northeast Ohio Aggregation Coalition.

Mr. Craig I. Smith
2824 Coventry Road
Cleveland, Ohio 44120

On behalf of Material Science Corporation.

- - -

INDEX

- - -

- - -

INDEX

\- - -

\- - -

Monday Morning Session,
October 20, 2008.

- - -

EXAMINER PRICE: Let's go back on the record.

Good morning. This is our third day of hearing in Case No. 08-935-EL-SSO. My name is Gregory Price. With me is Chris Pirik. We are presiding over today's hearing.

Do we have any preliminary matters for the Bench before we take our first witness?

MR. BURK: Yes, your Honor, just one. What I would like to ask the Bench is to clarify the ruling around the distribution case aspect of the companies' ESP proceeding.

And what I wanted to make sure is that I understand your ruling from the prehearing conference correctly that the Attorney Examiners weren't deleting -- or, yeah, deleting any aspect of the ESP cases filed, they were just excluding evidence of the distribution case with the understanding as was stated that a distribution case order is going to be issued.

But the clarification I was seeking was that the Bench didn't make any changes to the ESP cases filed by the companies.

EXAMINER PRICE: No, we are not intending on changing any aspect of the ESP case as filed by the case.

All we are saying in the interest of administrative efficiency is that can be decided in the distribution rate case, will be decided in the distribution rate case and all other matters then will be cited in this case.

MR. BURK: Thank you very much, your Honor.

EXAMINER PRICE: Thank you.

Anything else?

Seeing none, Mr. Hayden.

MR. HAYDEN: Thank you, your Honor. The companies call Dr. Jones.

(Witness sworn.)

EXAMINER PRICE: Please be seated and state your name and business address for the record.

That's the first test to be qualified as a witness, if you can make the microphone work.

THE WITNESS: My name is Scott T. Jones. My business address is 20 University Road, Cambridge, Massachusetts 02138.

EXAMINER PRICE: Please proceed,

Mr. Hayden.

MR. HAYDEN: Your Honor, if we could have marked for identification purposes the direct testimony of Scott T. Jones as Company Exhibit 6.

EXAMINER PRICE: So marked.

(EXHIBIT MARKED FOR IDENTIFICATION.)

- - -

SCOTT T. JONES

being first duly sworn, as prescribed by law, was examined and testified as follows:

DIRECT EXAMINATION

By Mr. Hayden:

Q. Dr. Jones, do you have before you what has been marked as Company Exhibit 6?

A. Yes, I do.

Q. And is that your direct testimony in this proceeding?

A. Yes, it is.

Q. And do you have what has been marked previously as Company Exhibit 10?

A. Yes, I do.

Q. The list of errata items from the company?

A. Yes.

Q. And are you responsible for those errata items by which your name is identified?

A. Yes. Those are errata items 31 through 33.

Q. Thank you.

And subject to those errata items, do you have any further additions or corrections to your testimony at this time?

A. No, I don't.

Q. And if I were to ask you the same questions that are identified in your testimony today, would your answers be the same?

A. Yes, they would.

Q. Thank you.

MR. HAYDEN: Your Honor, the witness is available for cross.

EXAMINER PRICE: Thank you.

Mr. Small.

MR. SMALL: Thank you, your Honor.

\- - -

CROSS-EXAMINATION

By Mr. Small:

Q. Good morning, Dr. Jones. My name is Jeff Small. I represent the office of the Ohio Consumers' Counsel. I believe we met telephonically a while back.

A. We did, yes.
How are you, Mr. Small?
Q. I have a few questions for you today. Let's get right to it.
If you could turn to your page 2 of your testimony.
A. All right.
Q. And line 16 and the related footnote 1 that's on -- connected to line 16.
The footnote states that your calculations, based on market data as of July 15, 2008, which is exactly the same date found in Mr. Graves' testimony.
The direction to use July 15, 2008, is from the FirstEnergy companies, correct?
A. Yes.
Q. Would you please turn to page 7 of your testimony, lines 10 through 11.
Do you have that?
A. Yes.
Q. And at that point in your testimony you mention round the clock energy prices for each year, and on line 11 it says shown on Exhibit 2.
Do you see that?
A. Yes.

MR. SMALL: Your Honor, at this time I would like to mark an exhibit to discovery questions and an Excel spreadsheet OCC Exhibit 8.

EXAMINER PRICE: So marked.

(EXHIBIT MARKED FOR IDENTIFICATION.)

Q. Dr. Jones, I have marked a small packet of papers as OCC Exhibit 8 Responses to OCC's Request for Production 85 and 86. Those are the first two sheets.

Do you see that?

A. Yes, I do.

Q. And they state that you are the witness responsible. Are you the witness responsible for these responses?

A. Yes.

Q. And attached to that a number of pages which is a printout of an Excel spreadsheet which was -- is promised in the companies' response to request for production 85 and 86.

Do you see that?

A. Yes, I do.

Q. And is this material the materials, the information, that was supplied by you or on your behalf?

A. Yes, as far as I know, yes.

Q. Okay.
EXAMINER PRICE: Mr. Jones, Mr. Small, on pages 4 of 11 and --
MR. SMALL: Yes, let me clarify that.
EXAMINER PRICE: Thank you.
Q. As the Attorney Examiner was about to observe, there are some handwritten marks on these documents which are intended to guide the eye while we are doing the cross-examination, so the titles at the top of the page, those are not the companies' but were added by the OCC, correct?
A. Yes. You asked me about the data. I assumed you were ignoring the handwritten remarks.
Q. I am ignoring them, and as the Attorney Examiner was about to comment, on page 4 of 11, set 1, there are some handwritten marks in the margin, and that was also not supplied by you; is that correct?
A. That's correct.
EXAMINER PRICE: Thank you.
Q. I believe -- if there are any other handwritten marks in the margin, those are also provided by the OCC and not by FirstEnergy, like on the very last page.
A. Yes. There is some on -- that's correct.

Q. We will be using those in the questions. I would like to work some of your calculations and for that purpose I have added the handwritten notes so that we can find our way in the spreadsheet, which is a little bit difficult to navigate without the notes.

First, the spreadsheet provides -- the spreadsheet provided shows daily values for future prices off peek and on peak for 2009, 2010, and 2011, correct?

A. That's correct.

Q. Would you please turn to what I have marked as set 1, 4 of 11. I think we were just there.

I just want to go through a little bit about how these tables are put together so we can find the numbers.

Do you have that?

A. Yes.

Q. Okay.

A. Recognizing you are about to describe a spreadsheet on a screen to be continuous, not breaking into pieces.

Q. Yes, I know. That's the difficulty. That's the reason for the handwritten notes, so we can find everything.

The data that you used in constructing your Exhibit 2 that is using July 15, 2008, that's the date shown for -- on set 1, 4 of 11, as I have marked it, correct?

A. Yeah, for the forwards for that day.

Q. Forwards for that date. For 2009, 2010, and 2011?

A. Correct.

Q. And for on peak and off peak?

A. Correct.

Q. Okay, and turning to what I have marked as set 4 of 11, that's where we find the values for that date; is that correct?

A. For July 15?

Q. July 15.

A. I don't know about the set 2 part. Mine says 4 of 11. Is that what you are referring to?

Q. There are two sets of pages 11 in each set. And the reason for this is normally it goes across the screen but when you print it out, it comes out in two different sets.

A. Right.

Q. On 4 of 11, second set, you recognize those numbers as numbers that you used in your analysis, correct?

A. Correct.

Q. Okay. And just to complete this table, this information that you provided runs through September 15, 2008, correct?

A. Yes.

Q. And that's shown on -- if you could go to set 1, 11 of 11, to the very end of it, this table is constructed to show September 15, 2008, is the last date, correct?

A. Correct.

Q. And the corresponding numbers are in the second set of numbers.

A. Correct.

Q. All right. I am going to use these in combination.

MR. SMALL: Your Honor, I would like to mark OCC Exhibit 9.

EXAMINER PRICE: So marked.

(EXHIBIT MARKED FOR IDENTIFICATION.)

Q. Now, Dr. Jones, you have had a moment to look at Exhibit 9.

Subject to check, if you want to take a moment to look it over, does exhibit -- OCC Exhibit 9 show the -- show plots of the numbers that are contained in the Excel spreadsheet that is on peak and off peak for 2009, 2010, and 2011?

A. Well, subject to check, the trend appears correct anyway. I haven't checked every individual entry.

EXAMINER PRICE: Do you want to take some period of time and at least randomly check some of these?

THE WITNESS: I could do that, yes.

EXAMINER PRICE: Let's go off the record for 5 minutes, and if you need additional time after that, we will give it to you.

(Recess taken.)

EXAMINER PRICE: Let's go back on the record.

Q. (By Mr. Small) Dr. Collin, we have taken a short break. During that time have we been able to establish -- would you agree with me the plots correctly state the data in the spreadsheet?

A. A couple of things. First of all, I am not Dr. Collin. If he were up here --

Q. Excuse me, Dr. Jones.

A. Second of all, I could only check four, and the problem is when you have got a numerical spreadsheet and give somebody a graph, you are asking me to read a number off a graph, so I don't know how precise I can be, but in general the four numbers I checked looked about right, given that you are asking me to read off the graph.

Q. I believe in a previous response you said that the -- you recognized that the trends looked right on the plots, correct?

A. Generally speaking, yes.

Q. Dr. Jones, do you -- do you review this type of information on a regular basis?

A. I don't have a set schedule. I look at it periodically.

Q. Have you looked at it since September 15?

A. Yes.

Q. Have these numbers trended generally lower from September 15 to present time?

A. Generally speaking, yes.

MR. SMALL: Now, during the break I handed out another two-page document that I would like marked as OCC Exhibit 10.

EXAMINER PRICE: So marked.

(EXHIBIT MARKED FOR IDENTIFICATION.)

Q. Dr. Jones, we are going to be looking at the first of the two pages on OCC Exhibit 10. Do you have that in front of you? Two pages of numbers.

A. Well, without careful review, they look like they are identical.

Q. They are not, but let's just look at the first page.

A. Okay.

Q. I would like to walk you through your calculations that resulted in your Exhibit 2.

At the top of OCC Exhibit 10, the first page, the July 15, 2008 off-peak and peak index prices that you used are shown, correct?

A. Yes.

Q. And next the number of off-peak and peak hours you used are shown in a column -- it's to the right of that table, correct?

A. Yes.

Q. Did we lose the microphone there?

A. No. I said "yes."

Q. Thank you. I didn't hear you.

And the next column shows the index price times hours. Subject to check, does that look like the correct multiplication?

A. It appears to be, yes.

Q. Okay. Now, for your numbers that you show in your testimony on Exhibit 2, you arrived at them by adding the numbers for the particular years, 2000 -- there's two numbers at the top of that page for 2009. You would add those numbers and divide by 8,760 hours, correct?

A. In simple English, my numbers are the weighted averages of the peak and off-peak hours for those particular time periods.

Q. Did you have any disagreement with what I -- I am just trying to work through this table.

You would add, for instance, for 2009 183,062 to 304,947, add those two numbers and divide by 8,760, correct?

A. Right.

Q. And those result in the numbers shown at the top right of this table labeled "Jones' Prices," correct?

A. Correct.

Q. Okay. In the middle of OCC Exhibit 10, first page, the September 15 forward index prices are shown and this is taken from OCC Exhibit 8.

Can you confirm that?

A. Well, like I said, to the extent I could compare a spreadsheet number with --

Q. No. I am just asking you to look the number up in the spreadsheet. Those are the numbers in the spreadsheet OCC Exhibit 8. They would be found on the second set 11 of 11.

This is the reason why I put the notes in the margin, so that we can confirm that those are the correct numbers. I have just transferred from OCC Exhibit 8 to OCC Exhibit 10.

A. Yes.

Q. Okay. And those numbers for September 15, 2008 as compared to the corresponding numbers on July 15, 2008, the September numbers are all lower than the July numbers, correct?

A. Yes.

Q. And that would be shown at the bottom of this table where the 84.5 percent, for instance, is -- is 33.15 divided by 39.25, does that look about right?

A. Subject to check, yes.

Q. Thank you.

Now, using the numbers in the middle of the table for September 15, 2008, again, the hours are shown in the column to the right of that -- those tables, and then there's a column "Index Price Times Hours."

Do you see that?

A. Yes.

Q. Does that look approximately right,

subject to check?

A. Yes.

Q. Okay. And the same procedure that was used to produce the numbers in the upper right-hand corner would be used, again, subject to check, would produce the numbers shown on the right-hand side called "September 15 Prices"?

A. Yes, subject to check, they are approximately correct.

Q. And then the delta is, again, the September 15 prices divided by the Jones' prices, does that look about right, subject to check?

A. Yes, subject to check.

Q. I have my daughter's calculator here, but I don't think we really need to go through that.

Now, do you agree that some years have different numbers of peak and off-peak hours?

A. Leap years, for example.

Q. There might be a different arrangement of holidays, for instance, as well?

A. Yes.

Q. Yes. Let's turn to the second page of OCC 10.

Now, when you did your calculations, you assumed there were the same number of hours peak and off peak for 2009, 2010, and 2011; is that correct?

A. That's correct.

Q. Okay. Would you accept that 2011 actually has fewer -- subject to check, would you agree that there are more off peak and fewer peak hours for 2011 compared to 2009 and 2010? Did you check into that?

A. I -- I don't recall looking at that.

Q. Okay. You were suggesting that the second table on OCC Exhibit 10 was exactly the same. The second table differs in the number of hours peak and off peak for 2011.

Do you see that?

A. Yes. It has 16 fewer hours.

Q. Okay.

A. Which would be 16 peak hours.

Q. Right. And more off-peak hours corresponding to that.

A. Right.

Q. Do you have any reason to believe that -- I represent to you that this table has been constructed the same way as the other table except for using different hours for peak and off-peak for 2011.

Do you have any reason to doubt that?

A. I don't have any reason to doubt the construction of the table, but I haven't checked as to whether or not there is one fewer holiday in 2011 or not.

Q. Okay. So if the numbers --

A. Or one more holiday, I should say.

Q. So if the numbers for peak and off peak were correctly stated on the second page then, then the resulting prices that we worked through for the Jones' prices and the September 15 prices would be correct, subject to check?

A. The arithmetic would be correct, other things equal.

Q. Right. Thank you very much.

A. Are we through with these exhibits?

Q. Yes, we are.

Dr. Jones, do you agree that -- I'm sorry.

Your calculations in arriving at Exhibit 2 of your testimony used forward prices. I think we have established that, right?

A. Calendar forwards, yes.

Q. When you say "calendar forwards," you mean for 2009, 2010, 2011?

A. No, it's the provision amount of fixed amount of energy for a 12-month period.

Q. And those are the periods.

A. That's correct.

Q. Dr. Jones, do you agree a forward contract price is the expected real-time price that would prevail at the term maturity of the contract?

A. Generally speaking, forward prices are the then-current market's best estimate of prevailing future spot prices at the maturity of the contract. That's my definition.

Q. Okay. That is then in theory you are trying to predict what the spot price will be in the future.

A. Generally speaking, yes. I'm not but that's the market's estimate.

Q. Okay. Would you please turn to page 14 of your testimony.

A. Okay.

Q. And line 11 where you discuss a 5 -- $7.50 per megawatt hour number. Do you see that?

A. I do.

Q. And that's for transmission and the ancillary service cost, correct?

A. That's correct.

Q. And that $7.50 is ultimately factored into your price for 2009 that was listed on page 2 of your testimony, correct?

A. That's correct. It's one of the cost components buildup to the price.

Q. Okay. Not only for 2009 but for 2010 and 2011 also?

A. It's an invariant number for those three years.

Q. Now, does that $7.50 get multiplied by the margins that you show on pages 25 and 26 of your testimony?

A. Yes.

MR. SMALL: Thank you very much. I have no further questions.

EXAMINER PRICE: Thank you.

Mr. Yurick.

MR. YURICK: I have no questions of this witness. Thank you.

EXAMINER PRICE: Ms. McAlister.

MS. McALISTER: No questions, thank you, your Honor.

EXAMINER PRICE: Ms. Fonner.

MS. FONNER: Thank you.

- - -

CROSS-EXAMINATION

By Ms. Fonner:

Q. Good morning, Dr. Jones.

A. I can barely hear you, I'm sorry.

Q. Good morning, Dr. Jones.

A. Good morning.

Q. Cynthia Fonner from Constellation Energy. We too had the opportunity to peak on the phone sometime ago.

A. Yes, we did.

Q. I want to have you turn in your testimony to pages 3 and 4. You make reference to the Revised Code in there, correct?

A. I assume you are talking about at the bottom of page 3, or are you talking about the entirety of page 3?

Q. In the entirety, and specifically you make reference to Sections 4928.143 and 142. Do you see that?

A. Yes, and 141.

Q. And I take it you are familiar with the Revised Code regarding standard service offers for electric security plan and market rate offers; would that be correct?

A. I am more familiar with the market rate offers than I am with ESP, but I am generally familiar with the code, yes.

Q. And are you familiar that an ESP to be found more variable than an MRO it must be more variable in the aggregate? Are you familiar with that language from the Revised Code?

A. Yes. I believe the language says something to the effect if the Commission determines that the ESP is more favorable in the aggregate than the MRO, then it can approve the ESP.

Q. And for purposes of your analysis, did you look at FirstEnergy's ESP?

A. I read through it, but because my task in this case was to calculate what essentially would be the market price as of July 15, I cannot testify as to the details, and I have no idea where some of the numbers came from.

Q. Are you familiar -- you indicated you are familiar with some of the aspects of the ESP. Are you familiar with the fact that the ESP contains a minimum default service charge that is nonbypassable, meaning that it would be charged to customers who choose an alternate provider for their generation supply?

A. It's my understanding, yes.

Q. Are you familiar as well that there is a standby charge that would be applied to those customers as well?

A. Yes.

Q. Are you familiar that there are generation deferrals that would be, again, applied to all customers, including those who are shopping, regardless of whether they took generation service from FirstEnergy?

A. I'm familiar that a generation deferral charge exists, but I don't know anything about the details.

Q. And you did not include any of those components in your analysis because you were looking only at the market rate offer; is that correct?

A. That's right. I was -- I was simply responding to what appears to be the statutory test in this case, which is the Commission is going to be asked to make a determination of favorable in the aggregate and you don't -- MRO is a totally different animal than ESP.

Q. And you were not yourself trying to compare the ESP to the MRO?

A. No.

Q. Now, with respect to -- and with respect to the MRO, you were not trying to find a competitive price for what FirstEnergy's ESP offering would look like; is that correct?

A. I am not sure I understand the question. The phrase that's throwing me is am I "trying to find a competitive price." I don't know what you mean by that.

Q. You are not trying to find out, for example, if an ESP-like product were bid competitively, what that would look like?

A. No, I am not.

Q. And with respect to the MRO, did you review FirstEnergy's specific rate offer from this proceeding?

A. Yes, I reviewed it.

Q. And are you aware that the MRO would impose upon customers that shop uncollectible amounts from those customers who continue to take generation supply from FirstEnergy?

A. Could you restate that, please?

Q. Certainly. Were you aware that as part of FirstEnergy's market rate offer that customers who take generation supply from a competitive supplier, by that I mean someone other than FirstEnergy, would nevertheless pay FirstEnergy for uncollectible

amounts related to generation supply from customers who take generation from FirstEnergy?
A. My recollection wouldn't -- probably wouldn't be that description, but there is what I would characterize as a nonbypassable charge.
Q. And did that factor into your calculations at all in --
A. No.
Q. -- for purposes of this testimony?
A. No.
Q. Would you agree that a customer who shops pays uncollectibles for other customers affects switching risks?
MR. HAYDEN: Objection, your Honor. This is outside the scope of Dr. Jones' testimony.
MS. FONNER: Dr. Jones talks rather exactly about switching risks in his calculation in the MRO.
EXAMINER PRICE: Overruled.
THE WITNESS: I'm sorry, I got lost in the objections and so forth. What was the question again?
MS. FONNER: Could you read the question back for me.
(Record read.)

A. I don't have an opinion on that, I simply haven't considered that.

Q. (By Ms. Fonner) But that that might be a consideration for a customer who is looking to shop; would you agree?

A. Well, the choice to shop is a decision at the margin, and the charge that you described, at least in the context of how I think you are using it or my understanding of it, would be -- tend to be a fixed cost.

So I don't know, you know, in that context it wouldn't be part of the decision calculus at all.

Q. Well, would you agree a competitive supplier themselves has uncollectible risks from their customers?

A. I would presume so. That's the nature of the markets.

Q. And that would be factored into the rate that would be charged to a shopping customer by a competitive supplier?

A. Again, it's hard for me to say what would be considered by any individual supplier, but to the extent that it was characterized as a risk in the expectational component of the supplier, then it would come into play.

Q. And you recognize that a shopping customer under those scenarios would be paying not only for the uncollectible risk of the competitive supplier but would also be paying for FirstEnergy's uncollectible risks associated with its generation of supply?

A. Well, not necessarily. That's what I said before. I said to the extent that the competitive supplier chooses to include that, that is, if he considers it to be a meaningful risk, perhaps, but that's going to differ from one supplier to the next. And it could actually end up being trivial in all cases.

Q. Let's step back.

When we are talking about the uncollectibles, you understand that we are talking about FirstEnergy imposing this charge on all customers, including those who take supply from someone else.

A. That's how they chose to structure their MRO, yes. That's my understanding.

Q. And in that case a customer who shops would be paying uncollectibles associated with FirstEnergy's customers as well as uncollectible risks for their own choice of supplier? Do you recognize that?

A. If such risks exist.

Q. Speaking of risks, you talk about switching risks in rather great detail, and on page 20 of your testimony you speak specifically of aggregation programs.

A. Okay. I am on page 20. Did you have a particular line in mind?

Q. You make reference, first of all, that currently on line 4, approximately 50 percent of residential customers and commercial customers are in jurisdictions with aggregation programs, correct?

A. That's correct, that's an approximation.

Q. And on lines -- begin on 15, you make the assumption that in the future those numbers will be 50 percent, 75 percent, and ultimately 100 percent of customers will take generation as part of a government aggregation group for 2009, '10, and '11 respectively; is that correct?

A. Let me be clear.

As I said in my deposition and as my testimony indicates, this is a characterization of the number of the percent of the customers who will have opportunity to shop. It's not a shopping forecast.

Q. And with respect to the aggregation programs themselves, Ohio allows for opt-in and opt-out aggregation programs; is that correct?

A. My understanding is you are in, and you have to opt out voluntarily.

Q. Okay. And for an opt out, there are certain steps that a community must take in actual order for that to be approved.

A. I haven't -- I haven't studied that.

Q. Okay. So you are not aware of the fact that in order to have an authorized aggregation program, the majority of customers in that jurisdiction must authorize that in an election?

A. Yeah. They have -- there has to be a deliberate action to avoid being part of the municipal aggregation program. You can't be a casual activity.

Q. And as part of that authorization, there has to be a plan of operation and public hearings?

A. I don't know what the level of detail is.

Q. And you don't know what time it might take for that process to be completed?

A. Well, we have -- we have an estimate of time in Steve Littlechild's report, his study of the marketplace, and this is getting in, albeit, but the period of time of that approximately one year.

Q. Okay. And with respect to the number of customers who have the opportunity to take service under an aggregation program versus that who actually do take service under an aggregation program, do you know what the percentage of customers are in Ohio that are currently taking service under a government aggregation program?

A. As of today?

Q. Yes, sir.

A. No, I don't. The incentives to participate in an aggregation program given an MRO as I have laid it out would be substantially different than the incentives there are today.

Q. And do you know what percentage who are taking -- participating in government aggregation programs are taking service from someone other than FirstEnergy's affiliate FE Solutions?

A. As of today, I have no idea.

Q. Now, government aggregation programs exist in other jurisdictions as well; it's not unique to Ohio, is it?

A. That's my understanding, yes.

Q. And your analysis does not take into

account -- you did not perform any analysis about aggregation programs in those other jurisdictions included in your testimony, did you, sir?

A. No. But, again, mine is not a shopping forecast. It's simply pointing out there is ample time for 100 percent of the customers in Ohio to become part of an aggregation program if they choose to do so.

Q. In talking about switching risks in general, are you aware of what percentage of those -- of customers currently are shopping?

A. I'm sorry?

Q. Are you aware of what percentage of customers in the FE service territory are currently shopping?

A. Not at this moment. The last record I have is, you know, the study from the Public Utilities Commission, but it's not in October or later.

Q. Now, turning to your calculation of the margin, it's my understanding that you relied on essentially two things, a report from the Illinois Commerce Commission regarding the comment, at Ameren auctions, and Mr. Graves' analysis; is that correct?

A. Yes. Those are the two references cited in my exhibit -- various Exhibits 7, 8, 9, 10.

Q. And you did not conduct any independent analysis of your own?

A. Well, no, except that I am generally familiar with those auctions. My company advised on some of those auctions.

Q. But the margins in those cases are not something that's published, but rather they are estimated or forecasted, correct?

A. Well, they are calculated from the difference between the -- the known costs and the actual amount bid at that point in time.

Q. And on page 25 of your testimony you use margins increasing for low shopping risk customers of 10 percent, 15 percent, and 20 percent for 2009, '10, and '11 respectively. That's on lines 13 through 15.

A. That's correct.

Q. And you did not include any workpapers for that particular figure, rather that is an assumption on your part; is that correct?

A. No. I'm sorry, I don't know what you mean I didn't provide workpapers. There's a cite to the appropriate references. In fact, I have, you know, Exhibit I believe it's 6 or 7.

Q. But it's essentially a simple

calculation; it's a mathematical calculation that can be performed?

A. Yes. What -- I did an array of auctions, an estimate of the percent of the margins in this case for low shopping risk customers based on the actual outcome of the auctions.

Q. And on pages -- on page 26, for higher shopping risk customers you essentially simply doubled that calculation; is that correct?

A. No. Again, if you go to the array of in this case high shopping risk customers, you would find these percentages would -- would mirror the individual percentages for the years in question.

Q. But, again, we are talking about a mathematical equation?

A. It's an analytical calculation.

Q. Mr. Small spoke with you about some of the price tests the Cinergy Hub -- and just to be clear, that's the hub that you used for your analysis, correct?

A. That's correct.

Q. And since the time of -- well, that was discussed since the time of your deposition, but in the months since your deposition those prices have continued to fall; would you agree?

A. Yes.

Q. And have you reviewed the prices at the Cinergy Hub, the forward contracting prices at the Cinergy Hub, prior to your testimony today?

A. Immediately after my deposition but not any time commensurate with today.

Q. You had checked the prices at the Cinergy Hub the day prior to your deposition; is that correct?

A. That's correct.

Q. And you did not -- you have not checked those -- did you not check those prices in preparation for your testimony today?

A. No, I did not.

Q. Would you accept, subject to check, that the current forward price peak at the Cinergy Hub is now $5 in 2009?

MR. HAYDEN: Objection, your Honor. He just testified he has not even looked at these numbers.

EXAMINER PRICE: Sustained.

Q. Would it surprise you that prices at the Cinergy Hub had fallen approximately 22 percent since your calculations of your July 15 price?

A. I have no way of making that

determination. I will stipulate that they are certainly lower.

Q. And it may be in order of that magnitude?

A. I have no idea what the order of magnitude is.

MS. FONNER: Nothing further.

EXAMINER PRICE: Thank you.

Mr. Smith.

- - -

CROSS-EXAMINATION

By Mr. Smith:

Q. Good morning, Dr. Jones. My name is Craig Smith. I represent Material Sciences Corporation, an industrial customer.

A. Good morning.

Q. Good morning to you.

I just want to get a sense of on Page 2 of your testimony you describe the purpose of your testimony.

A. Yes.

Q. What was your understanding would the FirstEnergy companies use your findings for in presenting this ESP case?

A. Basically according to the statute, my understanding comes from that which is the MRO was a -- would be used to compare and evaluate on the part of the Commission the proposed electricity security plan of the company.

Q. And based on your understanding of that purpose, you developed three prices; is that correct, for three different years?

A. You are -- I was required to do that, yes.

Q. Okay. And you stated those prices on page 1 of your testimony -- or actually on page 2 at the bottom.

A. Yes, subject to the small change that's in the errata for the second price.

Q. Okay. So those lines 14 through 16.

A. That's correct.

Q. Now, in undertaking your review, you were not attempting to find the FirstEnergy Solutions price, were you?

A. No, not necessarily. These are the prices that a third-party provider would offer in lieu of taking on a slice of the FirstEnergy's system supply for the SSO.

Q. And those -- would these be winning bid prices?

A. That would be my presumption.

Q. Okay. And you are also presuming that these prices were the result of having met the statutory requirements for the Commission to accept the bids as outlined in the statute you quoted in your testimony?

A. I'm sorry. I don't understand. I hear your question, but I don't understand what it is that it means.

Q. I'll strike the question.

It's also your understanding on page 4 that the Ohio FirstEnergy companies' standard service offer would require a full-requirements electric service; is that correct?

A. Yes.

Q. And could you briefly describe a full-requirements agreement.

A. It would be requirements for not only energy but capacity, ancillary services, and so forth. It would be the complete ball of wax.

That's why I characterized it a moment ago as stepping into the shoes of FirstEnergy for that slice of system.

Q. But what other types of agreements could FirstEnergy request rather than full requirements?

A. Well, you could have partial

requirements, in other words the provision of energy only.

Q. Okay. Now, in writing your testimony, were you writing it from the perspective of the operating companies or from the perspective of the potential generation supplier?

A. The potential generation supplier.

Q. Okay. Now, in order to begin your calculations, you looked at the directed cost components, correct?

A. Yes.

Q. And could I summarize those as publicly available or at least comparable -- quantifiable?

A. Well, you could certainly characterize them as numbers. Some of them came from the company themselves because some of the direct costs, for example, require actual load numbers that the company would know, but it is -- these are numbers that can be obtained.

Q. Now, did those numbers come from FirstEnergy Solutions?

A. I didn't get them from FirstEnergy Solutions. I don't know what the source of the numbers were. I acquired them from the witnesses in this case.

Q. Well, you understand the operating companies do not own generation?

A. I do that, yes, so my presumption is there has to be some -- the owners of the generation -- the owner of the generation units would have to provide that.

Q. Then you testify, page 5, about FE provided the load forecast data for the rate -- different rate classes.

A. That's correct.

Q. Now, did -- you received the load forecast requirements, right?

A. Yes.

Q. Now, was that only for, I guess, retail sales or -- stop that.

Are those retail sales forecasts or why don't you describe what kind of forecast you received?

A. The load data that I received were for the years 2005 to 2007, and so because my load numbers are the same as the LMPs for the same time period for things like load shaping calculations, so they are historic numbers in that regard.

Q. Well, how many megawatts would the supplier have to serve as a full-requirements generation provider?

A. They are listed in my exhibits.

Q. Okay. Can you summarize them quickly, not by customer class, just total amounts?

A. I don't know -- you mean off the top of my head what are the megawatts?

Q. I was just actually looking for a range.

A. I don't know without consulting because I was paying more attention to the individual classes but.

Q. Okay. So I can look at the exhibits and come up with my own conclusion?

A. That's correct.

Q. Okay. And -- now, based on that usage that is -- whatever that usage is that was the -- one of your foundations for determining the market price?

A. Yes.

Q. Okay. Now, am I correct that the margin is the subjective part of your analysis?

A. Well, it's not subjective. I didn't -- you know, it's not my number and my number exclusively in the sense that it was drawn from the results of auctions in the four or five jurisdictions where those auctions are taking place.

Q. Well, hypothetically if you were

testifying before the -- another state's commission that has shopping, would your testimony essentially be the same?

A. Under these terms and conditions, yes.

Q. Okay. So it's -- it's not Ohio specific.

A. It's not Ohio specific in the sense that -- well, we'd be talking about delivery to the Cinergy hub, and subsequently to the FE load forecast, because you have things like distribution losses and MISO charges, but the construct would be the same, yes; the numbers would change.

Q. Well, in looking at your analysis of the margin, which is another term for risks; is that correct?

A. That's correct.

Q. Okay. You put a lot of emphasis on shopping, true?

A. Yes. It was -- it is a large component. These components change. For example, this discussion today about the decline in the energy costs since my deposition or since the filing of this testimony is just a piece of what would go into the expectation of a third-party provider participating in an MRO today but, you know, capital cost, risks, and so forth are many times what they were in July today.

In fact, if you were to hold an MRO today, you might not get anybody to show up.

MR. SMITH: I move to strike that answer. I don't believe it's responsive.

EXAMINER PRICE: Overruled.

MR. SMITH: May I have my previous question reread, please.

(Record read.)

Q. Is that a yes?

A. Yes.

Q. And in putting that emphasis on shopping, you did look at this particular point in your testimony specific to Ohio situations, true?

A. Yes.

Q. And you reached certain conclusions, correct?

A. Yes.

Q. Now, in reaching those conclusions, did you look back at the history of Ohio between the year 2000 through 2008 in terms of shopping percentages?

A. Well, I'm certainly generally familiar with the percentages recorded in the Commission study.

I don't know -- and I do know that

shopping, let's say, last year was lower than it was during the initial days following the transition plan with all the incentives that were in place, but I can't tell you what the percentage was in '07 and certainly not today.

Q. Well, did you -- were you aware that many of the largest industrial customers had special contracts during that time?

A. During which time? I'm sorry.

Q. Between 2000 and end of 2008, special contracts in effect for industrial customers.

A. I have no idea whether that's true or not.

Q. Now, returning back to your price conclusions for 2009, 2010, and '11, can you estimate how much -- what percentage of those prices would reflect risk?

A. You mean outside of the calculation that I did to calculate the margin?

Q. Well, fundamentally how did you determine the risk?

A. Well, I -- we talk about -- talked about it here already this morning, but we had individual annual risks, let's call them risk adders, if you like, for '09 through '11 for low risk shopping customers and high risk shopping customers, and those percentages have changed as you move out in time but they vary from, you know, as low as 10 percent to 40 percent.

Q. And just in conclusion, those risks do not specifically address the risks that FirstEnergy Solutions would have if they are the competitive supplier?

A. It's the risk that anyone participating in an MRO would assess with respect to this margin.

MR. SMITH: Nothing further.

EXAMINER PRICE: Thank you.

NOPEC?

- - -

CROSS-EXAMINATION

By Mr. Breitschwerdt:

Q. Good morning, Dr. Jones.

A. Good morning.

Q. My name is Brett Breitschwerdt. I met you briefly a few weeks ago. I am here on behalf of NOPEC and Northeast Ohio Public Energy Council, which is currently the largest governmental aggregation in the state of Ohio, but we're excited based on your testimony that either we are going to get a lot bigger or we are going to have some serious competition in the next couple of years.

Let me start out by talking generally about your exhibits. The way your exhibits fit together, essentially Exhibits 2 through 7, you add all those numbers up and I think you referred to them earlier as direct costs, which gives you the market rate off prices for 2009, 2010, 2011 on Exhibits 8 through 9.

A. Well, I think -- I think the direct costs appear in Exhibits 2 through 5. The margins appear in Exhibits 6 and 7.

Q. Okay. So 2 through 7 incorporate the direct costs, and margin and total prices are on 8 through 10; would that be correct?

A. The price calculations are -- by class are on 8 through 10.

Q. Okay, and have you reanalyzed any of the calculations either of direct costs or margins based on your Exhibits -- within your Exhibits 2 through 7 since July 15, 2008?

A. No. In my opinion there is no need to.

Q. But if the Commission or Commission staff requested that you update this analysis, would you do so?

A. Well, if directed by the Commission, I assume my client would instruct me to do so, you are asking me to make an assumption, that's correct.

Q. All right. If you could turn to Exhibit 8 of your testimony, please. I just -- I would like for you to explain in the -- actually at the top you have residential high shopping risk customers, residential low shopping risk, and then commercial high and commercial low shopping risk customers.

Could you just explain why you separate these customer classes into these two categories, please?

A. Did you say page 8 or Exhibit 8?

Q. Exhibit 8.

A. Oh, I'm sorry. Hang on.

Okay, and your question went to why did I divide these customers into the various risk categories?

Q. That's correct.

A. The -- again, the risk categories go to the opportunity for customers to shop -- currently approximately half of FirstEnergy's customers are members of organizations like the one you represent.

And so the other half are not such that it -- in the first year of 2009 my presumption was that only those that were currently members of municipal aggregation organizations could participate and that's the reason for the division.

Q. And so essentially the risk of this difference is based specifically on the ability -- the current or future expected ability to participate in large scale government aggregation; is that correct?

A. And the risk that a supplier would be subject to, for example, in 2009.

Q. I'm sorry, the risk a supplier would be subject to in 2009?

A. Yes. It's not only shopping risks but there are other risks.

Q. Okay. In looking at the line where you state what the margin is, I see taking, for example, residential high and residential low, there's a 10-percent difference that you calculate there.

Would the -- that 10-percent difference be based on the ability to participate in a large scale government aggregation or are there other risks associated with that 10-percent difference?

A. The division between 10 and 20 is a subject that is driven by the opportunity to shop.

Is that what your question was?

Q. Yes. And you -- in your testimony you associate the opportunity to shop with the opportunity to participate in large scale government aggregation?

A. Right, but I don't want to leave you with the impression if you don't have the -- if you have a customer without the opportunity to shop doesn't mean that a supplier to the market faces no risk. In other words, it's not zero in this case; it's positive 10 percent.

Q. Correct, but the 10 percent difference between the 10 percent and 20 percent is what I was referring to and that 10 percent is based on the opportunity or ability to participate in large scale governmental aggregation.

A. Yes, carrying all other risks with it, and that's as a result of my analysis of the other auctions.

Q. Okay. And then in 2010, just to go through your Exhibits 9 and 10, that risk would -- the difference in those risks would -- I'm sorry. Let me strike that.

The amount of risk that you associate with the opportunity to participate in large scale government aggregation would increase to 15 percent in 2010 and then 20 percent in 2011, correct?

A. If you compare 2000 -- the exhibit for 2010, are you asking me to compare 2010 to 2009 or 20 --

Q. Please turn to Exhibit 9.

A. I have Exhibit 9.

Q. The margin between 30 percent and 15 percent is the 15 percent, correct?

A. That's correct. It's once again the increment of margin associated with the opportunity of more people shopping rather than less.

Q. Okay, and then in 2011 there is no high and low risk. You base the 40 percent -- or excuse me. Strike that.

For 2001 there is no high and low shopping risk, and the reason for that is your expectation that 100 percent of customers within the FirstEnergy service territory will have the opportunity to participate in governmental aggregation at that time.

A. That's correct. All customers within FirstEnergy's territory would have the opportunity to shop such that all customers would exhibit the same risk characteristics.

Q. And you allocate 20 percent of the margin for 2011 to that risk.

A. Well, simply as it shows there's no -- I haven't distinguished between customers in 2011. They all bear a 40-percent risk factor, so it's shopping risk plus other things.

Q. Okay. So I did the math, and I understand that you don't have a calculator, but just to -- for 2009 would you accept, returning back to Exhibit 8, that it would be, for the residential customers -- the additional risk of governmental aggregation would be $8.28 per megawatt hour?

And essentially what I did, I took the 82.82 which I calculate as the total direct cost and added on the 10 percent of the margin that you calculate resulting in --

A. You are taking the difference between column 1 next to the last line and column 2 next to the last line?

Q. Yes.

A. I had an arithmetic difference, that's correct.

Q. For commercial $7.98, subject to check?

A. Subject to check, that same arithmetic difference.

Q. Okay. And then just for my clarification, at the beginning you said in your errata sheet that, No. 31, that there is an error on your calculation 2010 market price but you -- I am not seeing where in your errata you explain what the miscalculation was or what the reason for the change was and I just want to make sure --

A. Look across the row total entitled margin, 30 percent, 15, 15, 30, 30 percent, 15, those number -- two numbers are reversed in the second column, and that also appears in the spreadsheet calculation since that caused the numbers to change.

Q. I see. But subject to check the difference in margin associated with participation in governmental aggregation 2010 for the rest of the country for residential customers will be $12.31 per megawatt hour, and then $11.85 for commercial customers, the arithmetic difference as you --

A. Well, I don't know if you can -- I haven't done it, and the number went down for '09, so I'm not quite sure that your arithmetic would be correct.

But it was a small change, so unless you are going to ask me to confer -- confirm a very specific number, we can probably move forward.

Q. Okay, I think that would be reasonable. I would just do the same thing for 2011, which there are no changes, so I assume my arithmetic is correct here.

It would be the difference -- the margin -- the percentage of the price associated with the margin related to participation in governmental aggregation which we discussed earlier would be $15.97 for the residential customers and then $15.83 for commercial customers, which would be 20 percent of that margin.

A. That's a calculation I have not performed, but I hear what you are --

Q. Subject to check, would that be the reasonable way to make that calculation?

A. I don't know about being "reasonable," but I understand your methodology.

Q. Would you agree with it?

A. It would be consistent with your method.

Q. Would it be consistent with producing the calculation that I am trying to get to essentially the margin associated -- the percentage of price associated with the margin related to governmental aggregation participation?

A. It would be -- it could be consistent with the methodology that you have employed from beginning with Exhibit 9.

Q. Okay. And looking at Exhibits 8 through 10, would you agree with me that the total direct costs to serve FirstEnergy load actually decreases over the three-year terms of either the electric security plan or --

A. I'm sorry, increases or decreases?

Q. Deceases.

A. Are you asking about the energy costs?

Q. I am looking at the total direct costs per megawatt hour as you set them forth on Exhibits 9, 10. My understanding is they decrease from 76.30 -- I'm sorry, starting on Exhibit 8, they decrease from 77.32 to 76.39 to 75.41 over the three years of your calculations.

A. That's right, absent the increasing risk factor all else equal.

In other words, if I had a constant risk factor, you would see decline in them, small declines but declines nonetheless.

Q. Okay. So we can -- based on your calculation of the margin is what results in the increase over the three years?

A. As it should. Risk always increases with time.

Q. Okay. In preparing your analysis what information, if any, did the companies provide you regarding customer participation in governmental aggregations?

A. Nothing.

Q. So did you request any information from the companies?

A. Well, I had -- like I said, I had the Commission's study with respect to historical information, and I presumed your question went to time periods after that study was completed.

In other words, you are asking me did they -- did I ask them and did they tell me what current participation was?

Q. Or did you get any information from the companies regarding participation in governmental aggregation?

A. Nothing other than what appears in that study. I am not sure that they know. I have no idea.

Q. Did you review the sections of Senate Bill 221 relating to government aggregation?

A. Yes.

Q. And how did these sections of 221 inform your analysis of customer participation in governmental aggregation during the three years 2009, 2010, and 2011 that you discuss in your testimony?

A. The structure of the Bill is such that if an MRO is the path that the Commission chooses to pursue, that they will have put into place a heightened incentive for customers to participate in a government aggregation program.

Q. And can you explain what that incentive is?

A. They will -- once the Commission accepts the MRO process, the ESP is off the table for residents of Ohio, and the residents of Ohio for FirstEnergy companies will be subject to whatever bid comes in, whatever winning bid comes in from the marketplace, and that winning bid will establish the then-current level of electricity price, at least for the year.

And depending upon the trend in energy prices from that point forward, given the freedom to choose, consumers will -- will presumably make that choice at the margin. In other words, they will be free to enjoy the opportunity to shop.

Q. Did you review the Senate Bill 221 provisions regarding governmental aggregation with relation to the electric security plan provisions of that Bill?

A. You would have to point me to that portion of the Bill.

Q. Okay. Which portions --

A. I don't have it in front of me.

Q. That's fine. Which portions did you review?

A. Well, I read the Bill. What you are referring to doesn't spring to mind so that's why I was asking you to refer me to a particular section.

Q. To your knowledge are there different provisions relating to governmental aggregation in the electric security plan as opposed to the market rate option is selected?

A. I don't recall off the top of my head.

Q. So assuming they are not different provisions and provisions related to governmental aggregation are the same regardless of whether the ESP or MRO would be selected by the Commission, your analysis would, I guess, hold true, so to speak, regardless; is that a fair statement?

A. Yeah. Let's be clear.

I mean, the ESP offers the Commission an opportunity to effectively negotiate one-on-one with FirstEnergy, whereas, the MRO throws the entire process and all the risks associated with the process open to the marketplace.

In other words, the MRO means the Commission has to have the stomach for taking on what, in my opinion, are much higher risks than they were in July.

And if they choose to do that, they choose to do that, but we are talking about two different animals and there's no way to make an MRO an ESP or vice versa.

It makes no sense so, yes, my MRO calculation stands today and is equally relevant, which is why I made a comment a moment ago there is no reason to recalculate this thing.

Q. I understand that. I'm just saying to say specifically related to the risk of governmental aggregation participation which you calculate is a large risk based on the incentives within Senate Bill 221, if those -- if those provisions of Senate Bill 221 apply equally regardless of whether an electric security plan or market rate option is selected, would those risks be equal -- the risk of participation in large scale governmental aggregation? I think that's the question.

A. Well, actually I haven't considered it, but as I sit here, my reaction would be it would be dependent upon the terms and conditions of the ESP.

Q. Okay. In preparing your testimony did the companies provide you with the proposed electric security plan?

A. Well, yes, because it appears in their proposal.

Q. I'm sorry, the electric security plan?

A. Basically the terms of the plan. I don't have the details, no. I don't know what went into the calculations.

Q. So when they were developing the electric security plan, they provided it to you --

A. No, no. I thought you were asking me ex post do I know what's in it, and the answer is generally I am familiar with what's in it, but I had no input while it was being developed.

Q. So it's fair to say the electric security plan as being proposed had no impact on your testimony?

A. No. It wasn't my charge, and it isn't the statutory test.

Q. Okay.

A. It didn't make any difference to me what they proposed in terms of my tasks in this case.

Q. So it would also be fair that the

companies didn't provide you any forecast or analysis of the number of customers they expect to participate in governmental aggregations during 2009, 2010, and 2011?

A. That's right, because it's irrelevant for my study. Remember, I don't have a shopping forecast in my MRO. All I have is a measure of the opportunity to shop.

Q. It's irrelevant to your analysis what the companies expect to -- sorry.

Just to state back to you what I think you just said, it's irrelevant to your analysis what the companies' forecast of their expectation or participation in governmental aggregation is during the term of the plan?

A. Are we talking about with respect to the ESP or the MRO? Does it matter?

Q. Neither of these -- neither of these options have been selected at this point, but Mr. Warvell stated on the plan a few days ago that the companies have a forecast and expectation of what customer participation in governmental aggregation would be in the year 2009.

Would that be relevant to your analysis?

A. Not really, no. I suspect any provider under the MRO might have their different expectations that might differ from Mr. Warvell.

Again, it's not relevant to my forecast -- excuse me, to my estimate.

Q. So it wouldn't be relevant to your estimate or your analysis that the companies expect zero percent participation in governmental aggregation in 2009, whereas, you propose 50 percent participation in governmental aggregation in 2009?

A. I didn't propose 50 percent participation. I simply indicate that the opportunity to participate is available to have other customers.

MR. BREITSCHWERDT: One moment, your Honor.

Q. Would you agree with me in negotiating an arm's length contract companies' standard service offer -- assuming the electric security plan would be approved, would you agree with me that negotiating an arm's length contract to meet the companies' standard service offer it would be economically unreasonable for FirstEnergy Solutions or any other supplier of generation not to take the risk of shopping into account?

A. Okay. Slowly, because that's a long

question. Go ahead.

MR. BREITSCHWERDT: Would you mind reading it back, please.

(Record read.)

A. Tell me who is negotiating this arm's length transaction.

Q. Let me clarify it. That wasn't clear, I apologize.

It would be the operating companies' -- this is the electric security plan proposal the operating companies' are proposing to contract with FirstEnergy Solutions to supply generation over the three-year term --

A. Okay.

Q. -- for ESP.

So would you agree with me in negotiating that arm's length agreement which has not yet been negotiated that it would be economically unreasonable for FirstEnergy Solutions not to take the risk of shopping into account?

A. Well, my presumption is that they would certainly -- they would consider not only shopping risk but all other risks facing them as a provider of energy in all other -- you know, full service requirements to meet this contractual obligation.

I mean, shopping should just be one of several risks they are taking.

Q. And that would be -- and that risk would be incorporated into the price that they would negotiate with the operating companies.

A. Subject to the terms and conditions of the ESP as approved by the Commission.

Q. But if they are negotiating an arm's length contract, the terms -- I mean, they are one entity over here that it's economically in their best interest to obtain the best price they can, so the terms of the ESP would be the operating companies' responsibility, so they are trying to negotiate a price where they can sell generation based on the risk they perceive, correct?

A. Well, I don't -- you know, I'm not trying to be difficult here, but any supplier of full-requirements service will take into account whatever risks they perceive, just as you would do if it was an auto company or grocery store.

I mean, there is nothing unique about this electricity market except that there are certain things that have to be met, but it's still like any other arm's length transaction; you always take into account risks.

Q. Okay. Thank you.

During your deposition we spoke, and you made a couple of comments I just want to follow up on.

You made a comment that shopping has historically been highly variable in FirstEnergy's service territory, and you explain that by saying that with the propensity of customers to shop tended to increase with the opportunity to shop.

Do you remember that statement?

A. Yes. I think the study shows that shopping increased over time over the term of the Commission study.

Q. And do you recall what the term of that study was?

A. I think -- not off the top of my head, but my recollection it's somewhere between 2001 to 2005 or '6.

Q. I think based on your testimony you say that the highest level of shopping was in 2004.

A. Okay, 2004.

Q. 2004.

A. I don't recall off the top of my head.

Q. But you -- I think you stated earlier you are unaware of the levels of shopping currently or after the period of that study which you relied on; is that correct?

A. I don't know the specific levels. I know that shopping has tended to decrease with the absence of the incentives.

EXAMINER PRICE: Okay. I need some clarification on this issue because this came up earlier.

You know that shopping has tended to decrease; is that correct, over time?

THE WITNESS: From 2004.

EXAMINER PRICE: Right. But in 2009, you say I treat 50 percent of these customers as taking generation from service; is that correct?

THE WITNESS: Let me be clear, Judge. And maybe it's the word "take" is confusing people.

None of this is a forecast like those studies based on hard numbers and people that actually shop. It's simply half of their consumers will have the opportunity to shop because they are already signed up with the municipal aggregators.

It's not an estimate of how many will shop. It's what is the opportunity because it's the opportunity the potential suppliers will use to gauge the shopping risk.

Because nobody knows exactly how consumers will behave in the future, but given the opportunity you have to assign a significant --

EXAMINER PRICE: I am having trouble harmonizing the words on the page with the words in here. What I see you saying at page 20, lines 14 through 17, is "In my analysis, I treat 50 percent, 75 percent, and 100 percent of these customers as taking generation service as part of a governmental aggregation group...."

Now, that doesn't seem to me to say having the opportunity to take generation service. That says taking generation service as part of a governmental aggregator group.

THE WITNESS: Well, perhaps it's an unfortunate choice of words on my part, but elsewhere in my testimony and certainly in my deposition and today I've tried to make it very clear that it's the opportunity to shop based upon the -- having had people -- having signed up people for these municipal aggregation programs, it's not a shopping forecast, however.

EXAMINER PRICE: You are assuming by 2011 100 percent of FirstEnergy's customers will have the opportunity to shop as part of a governmental aggregation?

THE WITNESS: A third-party provider to this market would have to consider the fact that because it takes approximately a year to sign up folks that aren't signed up, that by 2011, everyone could be signed up.

EXAMINER PRICE: Now, I understand. Thank you very much.

THE WITNESS: Okay.

EXAMINER PRICE: Thank you.

MR. BREITSCHWERDT: Thank you.

Q. (By Mr. Breitschwerdt) And just as a follow up, we discussed Senate Bill 221 earlier, and you would agree that Senate Bill 221 is supportive of the opportunity of Ohio consumers to participate in large scale governmental aggregation, correct?

A. Yes. There is nothing in the Bill that says people are somehow restricted from having the opportunity to shop.

Q. Okay. Also following up on your deposition, we had a discussion and you made the statement in response to a question that I asked that you would be troubled by the premise that the company's proposing its electric security plan in assuming that there will be no shopping.

Assuming that, this premise that the companies are proposing their electric security plan and assuming there would be no shopping would be correct, why would this trouble you?

A. Well, I don't recall that I said those exact words, but I can answer your question.

The -- as I understand it, the companies -- Mr. Blank, I believe, is the witness for the ESP, he starts with the notion of no shopping.

And that's simply so he can ground his analysis in a world of knowns or absolutes rather than having to say something about shopping, just as I have for that matter.

In other words, I make a recommendation to the fact that in my testimony that the way I've essentially set up the calculation of the direct costs is to assume essentially that they are somehow known, and then with the risk factor that I add on it adjusted those hypothetically known from a hypothetically known but those calculated known costs upward to account for the risks in each of those categories too.

Let me make sure I don't leave you with the impression my calculation is direct cost just because I can calculate them makes them somehow absent of risk. They're not. They are loaded with risk.

In addition to the risks that are less easily calculated such as capital costs and load variable and things of that nature so that you have risks across this spectrum of costs whether it has to do with something you can look up in a Midwest ISO document or something that we have to estimate through other means. There's risks everywhere.

Q. Following up on another statement you made during your deposition, you stated that ideally it goes without saying FirstEnergy would like no customers to leave their service territory and shop.

Do you remember -- I guess will you accept you made that statement during your deposition?

A. I'll accept I made a statement something to that effect.

I was simply pointing out that it's a general business principle that any supplier, whether they are an electricity supplier or tomato supplier, would like to have a large market rather than a smaller market. It doesn't go to anything other than that.

Q. And would you agree this statement the general principle is equally true regardless of whether the security plan option or the market rate option is approved by the Commission?

A. Well, general principles are normally true across specific recommendations but, yeah, I don't -- I also don't want to leave you with the impression I am saying somehow they are going to configure the ESP to prevent people from shopping, because that's not what I am talking about either.

All I mean is the general principle larger markets because of economies of scale are more variable than smaller markets.

Q. And in -- within that statement that would include shopping by large scale government aggregations.

A. Within what statement?

Q. Within the statement that FirstEnergy -- FirstEnergy would like no customers who shop, so that would include shopping by large governmental aggregation.

A. No, it's not a statement by somehow restricting governmental aggregation the opportunity of consumers to shop, it's simply a general business principle bigger allows you to take advantage of economies of scale provision of any product but particularly capital intensive products such that electricity suppliers just like automobile manufacturers prefer a larger market share. That's all.

Q. Okay. If could you turn to -- back to Exhibit 8, please.

A. All right, I'm there.

Q. If you will allow me one moment to get there. I just -- the line that says "Load Shaping," I just want to clarify that you've included the same load shaping cost to the companies regardless of whether they are within the 50 percent that are -- you potentially would expect to have opportunity to participate in large scale government aggregation or not; that's correct?

A. That's right.

Q. So it's essentially irrelevant to the calculation of load shaping costs whether a customer has the opportunity to participate in large scale government aggregation; would you agree with that?

A. The only way that number would change, if I were making a shopping forecast, but I'm not. It's a -- the opportunity to shop.

And since I don't know what people actually are going to do, the number remains the same.

Q. Okay. If could you turn back to your Exhibit 3, please.

A. Okay.

Q. In looking at the year 2009, all classes, and then moving over to the load-shape price, would you agree with me that's the average price that the companies' shape load would be for this year?

A. 2008?

Q. I'm sorry?

A. 2008?

Q. 2009.

A. Oh, when you said "this year," I didn't know what you meant.

Q. I apologize. Looking over in the column year 2009 over to load shape price, the 59.92, which is all classes, is your average of the load shape price.

A. Well, the cost. It's the cost that any supplier would bear because individual load by customer class differs from block energy.

You would have to shape your load and it's based on the column A, for example, which includes the hourly LMPs and the hourly loads from 2005 to 2007, the last two full years of data I had when I filed my testimony.

So it's an estimate of the load-shaping costs for 2009 based on actual historical numbers.

Q. Now, that would apply to any supplier whether it was assessing the costs to serve this shaped load; is that accurate?

A. Because this is a full-requirements contract, they would bear the load-shaping costs by customer classes demonstrated here.

Q. And the full requirements either for MRO or the ESP because the --

A. I don't know -- I don't know about the components of the ESP. You are asking me about something I didn't put together. I didn't participate in.

These are the load shaping costs that face suppliers to the marketplace. I am not going to stipulate it's exactly what they would face in the ESP because I don't know how to do that. I didn't look at it, I didn't calculate it, I wasn't part it have.

Q. Okay. Well, talk in generalizations then if -- using your calculation of load shape price I see that the shaping costs for residential and commercial customers is twice as high or actually more than the load shaping costs for industrial customers in 2009.

A. That's right. That's typical of most markets.

Q. So would it benefit a supplier if there were 90 percent industrial customers and only 10 percent residential or whatever -- I'm sorry, let me strike that.

If there were -- if the number of residential customers and commercial customers was reduced hypothetically by 25 percent, would you agree with me that would improve the load shape that the supplier would be considering serving?

A. It would tend to lower the load shaping costs for those group of consumers, but by the same token it would dramatically increase the shopping risk.

So if you are going to follow that with "I am better off in that consideration," the answer is probably not. But, yes, your load shape number would go down on average.

Q. So taking the hypothetical that NOPEC served 25 percent of the companies' commercial and residential customer load, specific to just this load shape price, the remaining load shape price for the -- the SSO that potential suppliers would have to -- would have the opportunity to serve the load shape price prior to the margin that you discussed would go down; is that correct?

MR. HAYDEN: Excuse me, can we have that reread.

(Record read.)

A. Yeah, you are reciting a hypothetical where if you put it in the terms of hypothetical and restate it so I can understand it, maybe I will try and answer it.

Q. Okay, hypothetically NOPEC in a governmental aggregation certificate was 25 percent, just to use round numbers, of the residential and commercial customers in the year 2009.

A. Okay, so let me just stop you there and continue in a moment, just so I understand in your hypothetical.

We've now left 2008 and we are in 2009 sometime presumably toward the end of the year, and we observe that 25 percent of the customers that existed, the FE customers that existed let's say in '08 are now participating in your municipal aggregation program, is that it?

Q. Well, January 1, 2009 NOPEC signs a

contract hypothetically with a third-party supplier and they take 25 percent of the residential and commercial customers from FirstEnergy's load, and so this 36 million megawatt hours from 31 million megawatt hours for 2009 that you have in Exhibit 3 is reduced by 25 percent.

My question is what impact does that have on the load shape price that you average out under all classes for the remaining load?

I guess would you agree with me that the load shape price would be reduced and improved by those 25 percent residential/commercial customers not being served within the SSO because they have a higher load -- higher load shape cost?

A. Well, your load shaping cost by customer class is invariant to this. I guess, generally speaking, you have got a $5.50 cost to serve a residential customer in either instance.

But you are just -- I don't know where you are going with this arithmetic, if you are just leaving it on Exhibit 3, then the answer is I don't know, but it probably doesn't change and -- because I haven't done the calculation.

Q. But I think you -- in essence you have done the calculation, because you get to a 59.92 --

and I apologize, I am not trying to be complicated.

I am -- for all classes if you go over 59.92 under the second to last column is load shape -- is the load shape price which is the average of the numbers above the 61.21; the 61.28; the 58.21; the 46.89, multiplied by the load that those customers would be serving; is that correct?

A. The 4.22 for all classes is -- well, we could back our way through here.

Basically what you do is you begin by incorporating column -- column A, which subsequently ends up in column C and C ends up in E, which is part of the load-shaping cost calculation finally, because it determines out, but let's walk back to A and B for a second.

A and B are the total costs. Column A, for example, is essentially column B times the -- which is the QP times Q. The P is -- is -- I could back it out of A, but whatever it is is the way to get to the load-weighted cost.

And what I am saying is I haven't done the calculations to actually make the determination whether the far right-hand column changes in a meaningful way subset to 4.22, but in general if you change my mix, my load-shaping costs probably will change but I don't know that they would change in proportion to your 25 percent.

That's my problem. I don't -- without having done the estimates, I don't know whether you have a 1-to-2 ability to compare in your hypothetical.

MR. BREITSCHWERDT: That's all the questions I have. I appreciate your clarifications.

EXAMINER PRICE: I think we are going to take a break before we take Mr. Stinson's questions, but before the break I will ask -- I'll ask or I'll forget them during the break.

You indicated that although the market -- you agree that the market price of electricity has declined since the time you filed your testimony; is that correct?

THE WITNESS: The price of energy has declined.

EXAMINER PRICE: Price of energy but you have not recalculated the numbers.

THE WITNESS: No, I have not, Judge.

EXAMINER PRICE: And can you explain again to me why you did not recalculate the numbers?

THE WITNESS: Well, first of all, the statutory requirement is one that suggests that the

Commission ought to take our MRO estimate and compare it with the stand -- with the ESP.

The point in time that you do that it seems to me is pretty much your own. They have the basis for making a contemporaneous comparison because all the analysis underlying FirstEnergy's presentation in this case took place at approximately the same point in time.

If we were to redo it today, I would have to cite to the fact that while energy costs have declined, a number of other costs have increased dramatically, and the reason I made the offhand comment I am not sure anyone would show up, the capital costs for requirement for participating in an MRO are significant. And as you know by having read the paper or listened to the television, the capital markets have shut down. Letters of credit which are required to participate in market offers like this have gone through the roof, and every financial institution that I am aware of, and it's not just for electricity participation, it's across the board.

And so it may very well be that participants who would have been present in the hypothetical if this were done on July 15 wouldn't be there today. There are a lot of other risks that are much different than they were then.

Now, the question becomes then for the Commission, it seems to me, do I request an update of all the calculations and for the basis of my analysis in this case?

It strikes me as unnecessary. The Commission is being asked to make a determination in the aggregate, and as to the point in time the Commission simply has to say that the risks I would have taken on July 15 are different than now, and they may very well decide they don't have the stomach for the risks that would prevail today, particularly since a lot of them are unknown.

EXAMINER PRICE: I am curious about your offhand comment you are not sure anyone would show up. You are not representing on behalf of the companies that the MRO would be a pointless act at this time.

THE WITNESS: All I am saying there are key components in participation in an MRO today on the risk and cost side that are significant, and since the financial institutions tended to be the participants in historic auctions, a lot of those financial -- two things; some of those financial institutions are no longer with us, and those that are find themselves severely capital constrained.

I mean a financial institution has trouble participating in the short-term capital markets, not to mention the long-term market. They may not be able on behalf of their shareholders to participate in an MRO. Very significant risk.

EXAMINER PRICE: Okay. Thank you, let's take --

MR. STINSON: Your Honor, if I could, you are going to come back to me after the break. I want the record to reflect I will have no questions.

EXAMINER PRICE: Then we will come back to Mr. Lavanga after the break.

MR. LAVANGA: I will have a few.

EXAMINER PRICE: Come back at 11:15. Thank you.

(Recess taken.)

EXAMINER PRICE: Let's go back on the record.

Mr. Lavanga.

MR. LAVANGA: Thank you, your Honor.

- - -

CROSS-EXAMINATION

By Mr. Lavanga:

Q. Good morning, Dr. Jones.

A. Good morning.

Q. My name is Mike Lavanga. I am an attorney for Nucor Steel Marion. I have just a couple questions for you this morning.

A. All right, sir.

Q. Can you turn to page 10 of your testimony.

A. I'm there.

Q. Now, in this section you are talking about estimating the capacity costs that an MRO supplier would incur to meet the MISO resource capacity rules, correct?

A. Correct.

Q. So this is not an attempt to estimate the actual capacity or fixed costs of the generation plant used by the supplier to generate the kilowatt hours?

A. Well, because we don't have a final determination of the structure or methodology for calculating the market-based capacity cost estimate, what I did was take the estimate from FirstEnergy of the last contract they negotiated and simply held it constant through time.

So I'll admit there is a certain apparent disconnect between some effort to figure out what market capacity costs are going to be.

Q. Okay.

A. I mean, there is also no penalty provisions in here. We don't know anything. High degree of risk associated with this.

Q. Right. Just to be clear, the suppliers in Midwest ISO today don't get this capacity payment. This is a resource adequacy plan that's being developed by Midwest ISO?

A. That's right. What I did was stop short of any effort to fulfill whatever would be necessary if that plan were approved and we knew everything we needed to know.

Q. Okay. Dr. Jones, if a supplier ends up getting this capacity cost payment under the Midwest ISO adequacy rules, isn't it likely that the energy cost is going to be down because some of that capacity is going to be recovered through this -- this new energy or this new capacity payment?

A. Well, no, I can't -- I can't answer that in the affirmative because the missing piece is notably penalties for not maintaining enough capacity to satisfy the reserve requirement.

I mean, there is a lot of things in here we learned from, for example, experience in PJM and their capacity markets that third-party suppliers would have to take into account. It's just too fluid to make --

Q. How would penalties factor in? Let's assume that the supplier has met its resource adequacies requirement under the Midwest rule. They are going to get a separate capacity payment?

A. That's right.

Q. And so wouldn't you expect the energy costs to double somewhat to reflect that?

A. My only point is as I sit here today, I don't know that I could make that expectation. I simply don't know.

Q. Okay. And you just said before that you got the capacity price from FirstEnergy?

A. That's right.

Q. And this is -- was it based on a contract?

A. It was based on a contract for capacity in '09 and the first few months of 2010.

Q. Did you see this contract?

A. No, I didn't.

Q. Do you know who from FirstEnergy provided it -- provided you the price?

A. Mr. Warvell provided me the price.

Q. And when did you say you received that price?

A. Just prior to filing testimony so it would have been -- my understanding is it was a price that prevailed in the marketplace in early July.

Q. Okay. Can you turn to page 11 of your testimony.

A. Yes.

Q. Now, here on line 18 you say that you assume a -- a 113.5 percent reserve margin?

A. That's correct.

Q. And did you also get the reserve margin estimate from FirstEnergy?

A. Yes, I did. It was more in line of confirming an estimate because in other work that we have done for FirstEnergy and other work we have done elsewhere, this is the -- particularly for FirstEnergy, this is what they've used in prior studies, and I wasn't surprised at all when they said use 13-1/2 percent so.

Q. And when you say they used it in prior studies, do you know what those studies were?

A. Well, I have been involved with FirstEnergy -- representing FirstEnergy since the transition plan, and my recollection is even in the transition plan for an estimate we had -- we used 13 percent.

Q. Is it possible that the actual reserve margin is going to be higher?

A. Yes, it sure is. In fact, it wouldn't surprise me at all.

Q. And just to make sure I have your calculation right, you -- to calculate the cost of capacity for each kilowatt of peak demand, you would multiply the cost in this case 2.20 times the -- times 1.135 which will give you an effective cost of 250 per kilowatt of peak demand?

A. Well, we can look at the exhibit. Exhibit 4, and it's a simple matter of walking across the page.

You can see that we have the peak hourly load requirement is what is increased in order to determine the capacity, which is then multiplied by the 2.20 to get the cost per year -- annual cost per year per megawatt.

Q. Okay. Let's stay on Exhibit 4. Now, this exhibit is where you use the capacity costs to calculate class specific costs of supply for the MRO provider; is that correct?

A. Correct.

Q. Now, in your customer classes I notice you have residential, commercial, industrial. You don't have street lighting.

A. That's right.

Q. Why is that?

A. It was a very small portion of the total load, and we didn't break it out separately.

Q. So it's included in one of the other classes?

A. Frankly, I would have to go to the workpapers to tell you that.

Q. Dr. Jones, isn't it correct this exhibit demonstrates the affect of load factor on the price per megawatt hour of capacity?

A. By "load factor" do you mean if the peaks in -- the load peaks, the load shape?

It's simply grossing up the peak hourly load to reflect the necessary capacity.

Q. Well, would you agree that the load factors is the average load divided by peak load for a particular class?

A. By class, yes.

Q. Okay. Is it fair to say that the price per megawatt hour gets lower as the load factor goes up?

A. Yes. Given that it's an invariant cost per kilowatt month, that would be the expectation.

Q. So if you look at the cost per megawatt hour, take just the commercial class in 2009 as an example, the overall commercial load factor in this exhibit is lower than the industrial so the commercial class has a higher cost per megawatt hour; is that correct?

A. Yes.

Q. And the residential class has the highest cost per megawatt hour in this exhibit because it has the lowest load factor?

A. Well, it has -- it has a different peak hourly load. In other words, your capacity requirements to serve your residential customers and ultimately the shape of that load is substantially different.

Q. Dr. Jones, if you used a higher capacity cost than the 2.20 that's listed here, wouldn't that result in the price differential between the classes increasing?

A. If I were to use a -- another cost per kilowatt month that was constant and higher, would it result in an absolute difference in the far right-hand column; is that what you are asking me?

Q. That's correct.

A. Well, not having done the arithmetic but I -- any time you take -- the relevant relationship would remain the same. The numbers would change.

Q. The rel -- you mean the relationship between the classes would stay the same?

A. The percentage changes would stay the same because you are multiplying by a constant, but the numbers would certainly change.

MR. LAVANGA: Can you read that answer back, please.

(Record read.)

Q. Well, let's try to walk through an example here. Let's try doubling the capacity cost from 2.20 to 4.40.

A. Okay.

Q. Now, if you run the numbers through the way you have on your chart here, wouldn't that rate in the residential price at the end increase from 8.18 to 16.36?

A. Yes, but the all customer class, which is essentially the weighted average of the others, would simply double.

Q. Well, I am not asking about the all customer class. I am asking about the relationship between the residential, commercial, and industrial classes.

So if I -- we have the commercial under that example going up to 16.36. Then if we did the same thing for the industrial, that would give us --

A. 8.80.

Q. That's correct.

A. But those shares are the same, hence, the cross-customer number would simply double, say, if you have got higher numbers.

Q. Yeah, the differential is going to double as well.

A. Yeah, sure, of course. It's a constant.

Q. Okay. Let's turn back to the main part of your testimony for a second on page 14.

A. Okay. I'm there.

Q. Here you have a 7.50 per megawatt hour per price for transmission and ancillary services?

A. Correct.

Q. And that's an average cost?

A. Yes. That's a cost I am assuming that would apply to all customer classes.

Q. Would you agree that most of the transmission costs incurred by a supplier will be based on peak demands and not megawatt hour?

A. Actually I haven't given that any thought. I would presume other things equal, that's probably the case, yes.

Q. So as a result, they would actually vary based on class depending on peak demand of the class?

A. What is the term, "they would vary depending on peak demand by other class"? I don't get it.

Q. Well, the cost to the supplier.

A. Well, given this is a fixed number, any time you change the base to which this is going to be applied, the sum will increase, if that's what you are trying to ask me -- excuse me, the product will increase, not the sum.

Q. Now, I think my question is simply that if you agree that transmission costs will be based on peak demands, aren't -- isn't the cost to supply the various classes going to differ based on the class load factor?

A. The ultimate impact on the cost of fulfilling a contract with hypothetically different mix of industrial, residential, and commercial customers would certainly result in different aggregate costs based on this and another -- a number of factors that are driven off the peak load.

Q. Would you agree that because of the different class load factors as shown in your Exhibit 4 it would be more precise to assign these demand-related costs to each class by peak demand rather than simply applying an average?

A. Let me make sure I get this straight.

You are asking me -- now, Exhibit 4 doesn't contain this number you are referring to, you understand that?

Q. I understand that.

A. Okay. So given that it's not in this exhibit, what is out of this exhibit you are extracting and asking me to consider?

Q. The class load -- the class load factors reflected in Exhibit 4.

A. Column B?

Q. Yes.

A. Okay. Now, what am I going to do with column B?

Q. The question is simply -- well, the premise is the classes have different load factors, correct?

A. Yes.

Q. Wouldn't it be more appropriate to assign these transmission-related costs based on load factor, and wouldn't the costs be different based on cost factor rather than applying simply a -- your 7.50 per megawatt hour across all classes?

A. I guess I haven't considered that, so the answer is I don't know.

Q. Okay. Can you go to page 17 of your testimony, Dr. Jones.

A. All right. I'm there.

Q. This is where you discuss shopping risk.

A. It starts here, yes.

Q. And the margin in your calculation reflects shopping risk, correct?

A. In part, yes.

Q. And you said a pretty sizable portion of it is shopping risk?

A. Yes.

Q. It's correct the margin would be quite a bit smaller if there was no shopping risk?

A. Yes.

Q. Would you agree that the likelihood of classes shopping is highly dependent on the difference in price under the -- between the rate under the MRO and the rate in the the market for an alternative retail supplier?

A. Well, the shopping has a propensity to grow whenever the alternative price is more attractive to the consumer, or in this case the aggregator.

So that any time you have a significant differential between the prevailing price and whatever price emerges from the MRO, if it's favorable to the consumer, then, sure, the probability that someone will shop dramatically increases.

Q. Okay. Would you agree that whether a given customer class will shop is also very dependent on how the utility assigns and recovers its MRO costs from the different classes?

A. Well, again, I haven't taken into account alternative formulations of the MRO in the hypothetical, but I suppose it would be the case, yes.

Q. Have you analyzed the cost assignments and rate design of the FirstEnergy ESP proposal to determine whether there are going to be shopping risks that occur?

A. No.

Q. And did you assume any particular cost allocation or rate design in order to determine the margin and shopping risk under the MRO analysis that you did?

A. Did I determine what again?

Q. Did you use any particular cost allocation or rate design in your analysis?

A. Just what appears in my exhibits.

MR. LAVANGA: I think that's all I have. Thank you, Dr. Jones.

THE WITNESS: You're welcome.

EXAMINER PRICE: Mr. Boehm.

MR. BOEHM: Just a few, your Honor.

- - -

CROSS-EXAMINATION

By Mr. Boehm:

Q. Dr. Jones, my name is David Boehm, and I represent the Ohio Energy Group, which is a group of large industrial customers in Ohio.

I am going to jump around a little bit, Dr. Jones, because we've covered a lot of topics, but I want to start off with something pretty basic here.

You say in your testimony -- you describe the market in the Cinergy hub as a liquid market; isn't that correct?

A. That's correct.

Q. And you got your data from your Exhibit No. 2 from July 15 from that market; is that right?

A. That's correct.

Q. By the way, were those closing prices, or was that the difference between bidding and asked?

A. Settlement prices.

Q. Settlement prices.

Please tell me in your words what you regard as a liquid market. What are the characteristics of a liquid market?

A. The characteristics of a liquid market is a market in which there are sufficient numbers of buyers and sellers such that you can be confident that the price prevailing at that market accurately represents market conditions.

Q. So the products from which those prices were derived in your Exhibit No. 2 are based in -- not on hypothetical transactions but transactions that actually took place?

A. That's correct.

Q. Okay. Have you looked back to see to that -- to that market to see whether the Cinergy hub is still liquid?

A. Well, they have -- since the number of products that are available to that hub remain the same, my presumption is it is equally liquid today as it was then.

Q. Okay. Just a question in passing, you mentioned before that all risks increase with time.

Do you have any explanation as to why the numbers in your Exhibit 2 trend lower for the forward years?

A. They trend lower because the costs -- the direct costs tend to be lower.

Q. You responded, and I hope I am correctly characterizing this, to a question from the Bench about what I perceive to be that you concede that the prices of power have gotten lower of late, still lower than September 19 -- or September 15.

But I thought I heard you say to the Bench that after he -- after the ALJ asked you whether you had recalculated your MRO price that you didn't -- you didn't think that that was -- that was either important or relevant or likely change anything.

Please help me and give me -- give me a better idea what your response was, and then if you would -- did you say something like that?

A. What I said was I have considered it unnecessary.

Q. Okay. And tell me, please, why you think it was unnecessary.

A. Because the statutory requirement is that the Commission have before it a set of contemporaneous data, all of which were produced at the same point in time such that it can make a comparison in the aggregate between the company proposal in the form of an ESP and what a market rate offer would be at that point in time.

Whether you conducted that analysis on July 15 or whether you conducted it today, it seems to me that it doesn't make any difference, because as I explained to the Judge, there are a number of other risks that are dramatically heightened today that the Commission would have to take into account that weren't present on July 15.

But the two relevant dates, frankly, for considering prices under an MRO are July 15 and the date MRO takes place. Anything in between is just another calculation.

Q. You weren't implying, were you, Doctor, that the cost decline, the basic cost of energy, would affect both ESP and the MRO equally --

A. No.

Q. -- so that the relationship stayed the same, were you?

A. I didn't say that.

Q. I just wanted to make sure.
And you say the reason is that the only relevant points in time are when the MRO begins, the MR -- what was the other point in time?
A. I said July 15 or the date the MRO actually is offered to the marketplace. In other words, the date that the Commission has made its decision to reject the ESP and subject itself to the risk of marketplace.
Q. And why is July 15 the date on the alternative? I understand the MRO. Why July 15?
A. Because it's a date where we have a constant set of analyses that the Commission can feel confident that will allow them to make a comparison in the aggregate.
Q. And if they could get a constant set of data for a more recent date, wouldn't that statement be true of the more recent date?
A. It would be true of the more recent date, but it would in my opinion be a lot of unnecessary work.
Q. And it wouldn't be germane in your mind at all as to what the ultimate date -- price at the MRO was that the market had fallen significantly from July 15?

A. Let's be intellectually honest. Would you be asking me the same question if the price of energy had risen dramatically since July 15?

Q. Well, my motivation for asking questions --

EXAMINER PRICE: Wait a second. We are going to strike that response. That was way beyond nonresponsive. I am going to direct you to answer his previous question again.

MR. BOEHM: Would you read the question, please.

(Record read.)

A. Did you mean by that that you are asking me to assume when the MRO actually takes place, that the current price would still be in place; is that what you are asking me?

Q. No. I am just asking you for on your analysis if somebody had given you, say, the October 10 prices that you have on -- the equivalent of the October 10 prices that you have on your Exhibit 2 and said now give me your analysis of what -- of what the MRO prices would be, are you telling me you would still come up with the same end result as you have in your testimony now?

A. Of course not.

Q. Okay. You would come up with a lower number, wouldn't you?

A. Possibly.

Q. Okay. Under what circumstances wouldn't it be a lower number?

A. I explained to you before, you have -- now, if you were to do this today, you would have to separately consider risks that have risen dramatically in the aggregate which were not there, at least not as they are today, that may, in fact, in sum cause me to say that capital costs, for example, present a much higher risk today than even shopping risk so that you have a different mix of factors; that's A.

B, by the time the MRO actually takes place, we don't know whether or not the price cost will just as easily be going back up again as to be going back down. That's why I said really and truly the only other relevant date is the one when the Commission pulls the trigger and says we're not going to consider ESP, we are going to do an auction.

And at that point in time they will be faced with the market's perception of the cost of supplying the size and service of FirstEnergy.

Q. Well, I understand the second date, but

the first date is an attempt to guess what that number is going to be, isn't it?
A. Before the MRO it's an expert's best estimate of what that is going to be.
Q. Okay. And if markets are trending significantly downward, doesn't that represent in your mind a significant -- an important factor?
A. It's certainly a factor, but they could be trending significantly upward by the time MRO takes place.
EXAMINER PRICE: Excuse me, Mr. Boehm.
Isn't it the case the closer the date gets to the date when the Commission has to pull the trigger is -- the better data closer in time to when the Commission would have to make the decision is the better data the Commission could choose upon?
THE WITNESS: Generally speaking, the closer the date you get to the auction, the more reliable your estimates of the actual auction outcome will be.
EXAMINER PRICE: Thank you.
MR. BOEHM: Thank you.
Q. (By Mr. Boehm) Moving on to another subject, Dr. Jones, isn't it ironically true that the -- to the extent that you increase risk premiums

to reflect shopping risks, risks of shopping go up; wouldn't you agree?

A. I'm sorry, I don't understand that question.

Q. Okay. To the extent that a -- the alternatives to a customer are an MRO in the market.

A. Right.

Q. And the MRO reflects the companies' assessment of its risks that its customers will go shopping.

A. Who is "the company" in this case?

Q. Well, the supplier in this case FirstEnergy Services. Do you agree they are -- I'm sorry, used the -- I've fallen into the old habit of calling the utility "the company."

FirstEnergy Services, if, in fact, they turn out to be the supplier in this case, okay?

My understanding was what you are trying to do here is you are trying to gauge what the price of power would be based on a July 15 input and your assessment of risks that bidder or supplier would want to add on to those. One of those major risks as I understand it is the fear that its customers will go shopping.

A. That's correct.

Q. Okay. And what the customer was looking at is the MRO price on the one hand and he is looking at the market price on the other hand, right?
A. When you say "market," I am assuming you mean the alternative that's being offered, say, by an organization like Brett, like NOPEC.
Q. No. I'm talking about what the market would offer, the liquid market on the Cinergy hub.
A. Energy prices.
Q. Right. Yep.
A. And our energy prices at work here?
Q. Wouldn't that be the alternative for a customer if he was looking at an MRO price of, say, let's name something, $85 a megawatt hour and he was looking at the market price and the market price was $55 a megawatt hour, wouldn't he choose the market price?
A. Those are apples and oranges.
Q. Why is that so?
A. Because the MRO price is an all in price for certain system -- slice of system, and the energy price at the Cinergy hub is just that, it's energy at that location.
Q. I agree there are add-ons to that -- to that Cinergy hub price, but one of the add-ons is not

a risk premium, right?

The customer who went to buy on that market wouldn't have any risk that he was going to leave the system because he's just the customer. He would be buying -- he would be buying on that -- on that market. He wouldn't pay anything at risk premium, would he?

A. You -- who is this person that can buy energy to satisfy the requirements? I don't get it.

Q. He is the customer of FirstEnergy.

A. But the customer of FirstEnergy is hooked up to their transportation -- transmission distribution system.

I mean, it's not just the energy cost at the Cinergy hub, and besides that, the cost at the Cinergy Hub would be applicable to all purchasers that were attempting to supply this license.

Q. My question to you, Dr. Jones, if, in fact, a large industrial customer well capitalized decided I didn't like the MRO price, he could go in this Cinergy hub and buy product there, could he not?

A. He could hedge his cost in the Cinergy hub. He can't buy -- he can't enter into a contract and say deliver my power to me.

Q. Why can't he do that?

A. By incurring additional costs which may add up to your $84.

Q. Grant you, I am starting at the beginning now, which is the bare cost of power, right? And I want to discuss with you what you think are appropriate adders for that customer, okay?

Would that customer have to pay a shopping risk?

A. But the basis for your example is not the statutory requirement here. In other words, the statutory requirement asks the Commission to compare an MRO price cost, however you want to call it, with the -- with the program provided by FirstEnergy, and I don't get what -- what I don't understand is your insistence on incorporating a prevailing spot price at the Cinergy hub with either of those two examples.

Q. Let's go back to what I understood to be your definition of shopping risks.

Your definition of a shopping risk as I understood it was the risk that a customer would find that he could go out in the marketplace and get power cheaper than the MRO.

A. That's correct.

Q. Is that right?

A. That's correct, because I would then be required to supply -- I would be the winner of the MRO, and I would be supplying that slice of system for FirstEnergy's SSO customers.

Q. Now, what I am discussing is from the point of view of that shopper who may or may not make that election, what his perception of his alternatives are, aren't --

A. What election are you referring to?

Q. To go shopping.

A. All right. So he chooses not to shop.

Q. No. He chooses -- he is making the decision should he take MRO or should he go shopping, okay?

A. Okay.

Q. Now, isn't it, first of all, almost entirely true, given the construct of the MRO here that the -- that the shopping option for that customer will almost invariably be cheaper?

A. No.

Q. Isn't -- isn't that true because when he goes shopping, he won't be paying some of the add-ons that you have included from the MRO customer?

A. No.

Q. Will that shopping customer pay anybody a risk premium against the chance that he will go shopping?

A. Yes.

Q. Who --

A. He will pay a risk premium that's assigned -- that's built into the cost of supplying him power by whoever the third party is that's supplying him power.

Q. So in your example, then, of the MRO, there are two risk premiums; one from the seller, right?

How many risk premiums are there on the MRO?

A. There is just one risk premium.

Q. Okay. On -- let's take --

A. Shopping risk.

Q. For 2009, the $55.71.

A. The energy cost?

Q. Uh-huh, that's the energy cost.

Now, you are telling me that this -- this industrial customer in our example, when he goes shopping and he buys this product, he will pay the seller a risk premium on top of that 55.71?

A. Yes. Because the seller will have other customers he has to supply too because he is supplying his licenses.

Q. So you are saying when he goes to close the deal, he won't pay 55.71, he will pay 55.71 plus a risk premium?
A. Plus lots of other things, yes.
Q. No, but plus a risk premium?
A. My presumption is whoever is willing to supply him the power will assign a risk premium -- you started all this with shopping, so I will end it with shopping -- will apply shopping risk premium, yes.
Q. And how would this be assessed? In other words, the deal won't close at 55.71; it will close at that plus something?
A. Plus a lot.
Q. That he will pay to the seller.
A. Correct.
Q. I've never heard of this market. Tell me how that would be done.
A. Because he has to approach a third-party provider of electricity as much as for -- in place of approaching whoever the --
Q. You said a third party, didn't you?
MR. HAYDEN: Excuse me, could we let the witness answer?
MR. BOEHM: Go ahead. I'm sorry.

A. The only use that the Cinergy hub has for an industrial customer other than part of his negotiations with whomever is going to supply him the power is that he can hedge his exposure there, but other than that I don't understand the nature of your question.

Q. Did you say that he had to go to a third party?

A. You started this by contrasting your hypothetical customer in this case as --

EXAMINER PRICE: I think you need to answer his question directly and not reanalyze his question.

A. Someone other than providing MRO to -- I guess I was understanding you to be talking about.

Q. No, no. Let me go back again.

I'm a customer. I am buying on Cinergy's market. I see the board. It says 55.71. I say bingo, I want it. Do I pay that guy anything more than 55.71?

Forget about third parties. Do I pay him 55.71 or something else?

A. You mean the person that's willing to sell power at the Cinergy Hub?

Q. Yes.

A. No, you pay him the 55.71.

Q. That's what I want to know.

A. I'm sorry, if you are just buying in the open market.

Q. Is there anybody that I pay a risk premium to?

A. For that 55.71?

Q. For that same product, that same power that I am buying. Is there somebody I pay a risk premium to?

A. Not if you leave the power at the Cinergy hub, no.

Q. Okay. Now, isn't it true that a customer -- let's call it a well capitalized industrial customer then. His choices -- and this, as I understand it, reflects your definition of shopping risks.

His choices are he can go with the MRO or he can go with the market, granted you add on a lot of ancillary load following, da, da, da, on top of it, but there are some things that you have in the MRO that don't get added onto it, and one of them is a shopping risk, right?

A. Well, see, this is where -- this is where I have trouble understanding -- if you are just talking about compiling individual cost components as opposed to risk facing an MRO supplier to the FirstEnergy companies, if we've gotten away from the statutory requirements of this proceeding and we are now talking in a hypothetical about buying power at Cinergy and arranging for delivery to your factory somewhere, that's a very distinct and isolated event.

It's -- and I don't understand -- yes, you're right. I can always agree -- excuse me, arrange to take power at Cinergy, and if somebody is willing to negotiate with me, then I could probably get it delivered to my load sync, but I don't understand how that applies in this case.

Q. I'm not suggesting, Dr. Jones, that your job -- your testimony goes to the comparison of the MRO and shopping. It goes to the comparison of the MRO and I suppose it's going to be used in the ESP.

What I am looking at is what a customer's view will be in the real world when he sees your MRO price and what he perceives to be his economic alternatives?

A. Right, and that's why I said earlier that any large industrial unless -- well, any large industrial will most likely look at whatever prevailing price at the Cinergy hub at whatever point in time they are attempting to arrange this transaction.

And if they choose, they could buy the power directly for delivery of the Cinergy hub. A simpler way would be just hedge your position would be a lot cheaper but whatever you want to do.

Q. I am trying to do an apples to apples.

So it is true, is it not, Dr. Jones, that the higher the risk premium is to the extent it raises the MRO price and in comparison to the shopping price, the higher that risk premium is the more it, in fact, will induce shopping; isn't that true?

A. Certainly greater the differential between the prevailing MRO -- the contractual MRO price and prevailing market price will drive shopping, absolutely, greater that as that differential widens in a favorable fashion to consumers.

I assume you are not talking about it being higher than MRO but lower, then, yes, they would certainly be at an increased propensity to shop.

Q. Following up on one other question with respect to that shopping risk and the magnitude of that shopping risk, and this may be viewed as a truism, I guess, if, in fact, a customer base or part of a customer base, a customer class, said to the company "We will guarantee you that we won't go shopping in this three-year period" or whatever the period is, "to that extent the risk disappears," doesn't it?

A. No, because a verbal guarantee might be a nice gesture, but unless the contract is in place, my expectation is that as a potential supplier to market, those risks still exist.

Q. Well, I'm sorry. I wasn't -- I wasn't completely accurate. I didn't mean a verbal commitment.

I meant a contract. If he signs a contract and he waives his right to go shopping with respect to that customer, there aren't any shopping risks; isn't that true?

A. After the MRO is in place and if contracts are signed and for whatever reason they would sign them they will guarantee not to shop, then obviously that individual company shopping risk, the risk that company would shop, would go down, obviously, yeah.

MR. BOEHM: Thank you. I think that's

all my questions. Thank you, Dr. Jones.

EXAMINER PRICE: Mr. Bell.

MR. BELL: Thank you.

- - -

CROSS-EXAMINATION

By Mr. Bell:

Q. Dr. Jones, my name is Langdon Bell, and I represent the Ohio Manufacturers Association.

In response to a question by counsel for Nucor you had indicated, and to use your own terms, I believe you said "I have been representing FirstEnergy for about 10 years"; is that correct?

A. I don't know whether I said 10 years but certainly since we -- we were -- I was a witness for the company in their initial transition deregulation case.

Q. And have you provided services to FirstEnergy in the interim?

A. On occasion, yes.

Q. And as I understand it, your firm specializes in strategic planning, does it not?

A. No, I wouldn't say that. We specialize in litigation support and strategic planning mainly for energy companies but not entirely.

Q. Thank you, that was going to be my next question.

And the strategic advice that you provide energy companies is in large measure advice relative to regulatory matters; is that correct?

A. Well, it would depend upon what point in my company's life you were to ask me that question. Currently the answer is no.

Back in the late -- late '90s the answer to that question would have been yes simply because our involvement with companies undergoing regulatory matters varies from time to time. Right now, it's mainly nonregulated.

Q. In response to a question by counsel you had expressed -- maybe an expression with regard to current conditions, correct?

A. Correct.

Q. Current markets tightening up, locking up?

A. Capital markets, yes.

Q. Capital markets. Is that reflected in the fact that today investors are willing to take almost no return on short-term treasuries in order to secure the security of the obligation?

A. The demand for short-term treasury bills is an indication of a lack of willingness to engage in other forms of lending.

Q. Would you agree, Dr. Jones, that in times of uncertainty individuals and entities tend to become engaged in economic retrenchment being more conservative?

A. Yes, but it's usually a reflection of risk perception, and they tend to at some point withdraw from markets if it gets high enough.

Q. And that's true with respect to consumers purchasing any and all goods, automobiles?

A. It's true with respect to the human animal, yes.

Q. If, in fact, the economic conditions that we are currently witnessing become prolonged, would you expect that to affect -- dramatically affect the competitive market for electricity?

A. How do you mean "affect"?

Q. Well, I think you had indicated, for instance, that on MRO if -- if there was a competitive bid, you might not get any bids.

A. That's right, I did say that, yes.

Q. If there are no bidders, who is left to provide the service?

A. FirstEnergy, the load-serving entity.

Q. And if you are in FirstEnergy's position at that point in time, would there be a possibility absent regulatory oversight to abuse the market position held by FirstEnergy?

A. I don't have any reason to answer that yes or no. I don't expect, since they are a regulated entity, there was any abuse. It's a competitive market.

Q. In the next three years?

A. Correct. Well, for the next 30 years. It's a regulated market, and it's highly competitive.

Q. On page 20 of your testimony, you state on lines 14 and 15 "In my analysis, I treat...."

Do you see that?

A. Yes, I do.

Q. Paraphrasing that, is that statement reflective of you are assuming those percentages?

A. Frankly, I don't know if you were in the room, but we had this discourse, the Judge and I, a little earlier.

Q. I came in late, and I apologize. I have another practice.

A. I don't doubt that.

Basically it is my assumption that 50, 70, and 100 percent of customers would have the opportunity to choose to accept an offer by an aggregator as time passes.

Q. Could you not equally assume that for whatever reason any customer has 100 percent opportunity to date to choose another supplier?

A. That's absolutely correct, except for the small residential and commercial, it's harder for them to do it.

Q. You speak there with respect to aggregators that was formed in the early 2000 in the northeastern aggregation group?

A. That's right.

Q. How many other aggregation groups within the service territories of CEI, Ohio Edison, and Toledo Edison have been formed?

A. I don't know offhand. The Commission asked, I indicated there were a number of them, but I actually don't recall.

Q. Well, can you tell me with respect to -- do you know what percentage of -- or number -- what percentage of the customers of FirstEnergy's operating companies, total customers, what percentage were being served by aggregators?

A. It varies with time, but as of '04, it was approximately half. In fact -- well, it varied by the utilities, some as high as 60 plus.

Q. Number of customers 50 percent --

A. Oh, you are talking about residential/commercial customers.

Q. I am talking about total number of customers.

A. Oh, I don't know.

Q. But yet you are assuming when you say 50 percent, is that just residential?

A. No. It's the percent -- remember, this is not a load -- excuse me, this is not a shopping forecast. This is simply the number of total customers that would have the opportunity to shop. It's not a forecast.

Q. With respect to the other 50 percent, why do they not have an opportunity?

A. Because they are not currently signed -- well, they do in theory but they are not currently signed with an aggregator so the presumption would be that the opportunity to costs or whatever you want to say would be sufficient such that they could be assumed not to have the opportunity to shop even though, of course, by law they do.

Q. With respect to your risk assessment leading you to construct a margin, that is based upon historical analysis, correct?

A. Well, it was based on my assessment of the market as of July 15, so, I guess, yeah, it's historical in that regard.

Q. Well, it was also based for purposes of the shopping credit on the experience in the 2006/2007 time frame, was it not?

A. No. It was -- well, sort of it was based on the fact that as of today roughly half the residential and commercial customers are signed up with aggregators and that given the studies have shown it takes approximately a year to sign -- for the process to take place to sign up additional municipalities, that certainly there is ample time by 2011 to have signed up everyone.

Q. Do we today have a power supply reservation rider?

A. I'm sorry. Who is "we" and what are you referring to?

Q. Are today's customers today subject to a power supply reservation rider?

A. I don't know.

Q. Do you know whether today potential customers are subject to a minimum default service rider?

A. I don't know offhand.

MR. BELL: No further questions.
EXAMINER PRICE: Thank you.
Hospitals.
MR. SITES: No questions, your Honor.
EXAMINER PRICE: City of Cleveland.
MR. DUNN: No questions.
EXAMINER PRICE: Commercial Group.
MS. WUNG: No questions, your Honor.
EXAMINER PRICE: Staff.
MR. McNAMEE: I have a few.

\- - -

CROSS-EXAMINATION

By Mr. McNamee:
Q. Good afternoon, Dr. Jones.
A. Good afternoon.
Q. Let's talk about load shaping.
A. All right.
Q. Let's be very basic. If I'm a supplier, in order to cover my obligation, I'm going to go out and procure firm power out into the future. And I am going to procure enough firm power that I think it's going to cover my obligation; is that right?
A. Well, you are -- I am assuming you are not a generator and so that this is the case of anybody supplying this slice of service.

You would -- you would go into the marketplace and, for example, at the Cinergy hub you would obtain 5 by 16 blocks for peaks, and you would obtain the corresponding off-peak blocks to supply as much of that as possible.

And then you would engage in a load-shaping exercise to complete your analysis but you would always be subject to variations of load and load shape.

Q. Okay. So for any given hour I would endeavor to have enough supply available to me to meet the demand that I expect to have.

A. Presumably, yes.

Q. And I would be wrong in every hour?

A. Chances are, yes.

Q. Okay. Now, I could be wrong in several ways, okay? I could be long. I could have more supply reserve for myself than my demand actually turns out to be at that point.

A. That's correct, sir.

Q. Okay. In that situation I would take that extra power and I would sell it, wouldn't I?

A. Yes.

Q. Okay. Now, I would sell that for either more or less than the price for the firm power that I had already arranged for myself. I would sell it for something.

A. You would sell it for something. I don't know whether it would be more or less.

Q. That's exactly the point, you don't know whether --

A. You don't know. It's risk.

Q. Okay. Now, conversely, in a given hour I could be short. If I'm short, I need to go out and procure power.

A. That's correct.

Q. Okay. Power that I procure would be either more or less expensive than the firm power that I had set aside for that hour.

A. Probably more, since you found yourself short it means that demand is higher than you anticipated.

Q. Or I guessed wrongly.

A. Or you guessed wrongly.

Q. Okay. So in sum then we have sales or purchases, either gains or losses, and those all net out to something over time.

A. That's correct.

Q. Okay. Is there any -- take that back.

Companies have needed to do load-shaping exercises for a long time to do -- to perform this function that we have been talking about.

A. Yes.

Q. Okay. And FirstEnergy has done this presumably?

A. Presumably, yes.

Q. Okay. But there's no empirical source that we can turn to to look to see what these load-shaping costs have actually been over any historic period for FirstEnergy, is there?

A. Not without acquiring that information from FirstEnergy, I don't think you could, no.

Q. Okay. And that lack of information is why you have system -- or method for estimating this expense.

A. That's correct, and recognize, as I say in my testimony, that these calculations such as load-shaping costs are done with the expectation of certainty and so that the uncertainty which you eloquently presented the last few moments would be part of the risks that are added on separately.

Q. Fair enough.

Dr. Jones, what is LMP?

A. Locational marginal price.

Q. Okay, what does that mean?

A. It means the price prevailing at the various nodes throughout in this case FirstEnergy's service territory.

Q. Okay. When is LMP paid?

A. When is LMP paid?

Q. Yes.

A. You mean on what day? I'm sorry.

Q. Let me -- that wasn't a very well phrased question. Try again.

If I have reserved a given amount of power during a particular hour for myself.

A. Yes.

Q. As we discussed before, do I pay LMP for that power?

A. Well, the locational marginal price is used to determine the sort of the cost getting to the load zone, to the sync.

Q. Okay.

A. From the hub in this case in my analysis.

Q. Okay. And I am only -- but I'm only exposed to that LMP to the extent of my load following; isn't that correct?

A. And to the extent that you are moving power to that point for whatever the reason, yes.

Q. Okay. Do you have an idea of what

percentage of all the transactions that the company would do are used for -- or all the megawatt hours that are used for load shaping, any portion?

A. No, I don't.

Q. No idea?

A. Not as I sit here, no.

Q. But let me be sure on this. The only time that I'm -- that I have to pay LMP is when I'm procuring the load-shaping power; isn't that right?

A. Well, you are -- yes, that's true, and I guess I thought -- are you asking me do I know today what, for example, the costs are in my column A of Exhibit 3 which is based on '05 to '07 data? Do I know what that would be if I updated the table? The answer is I don't know.

But your question -- the answer to your question is yes, in general, yes, I am not disagreeing with you. I am just trying to understand what the dollar figure is that you are referring to.

Q. All right. Well, then -- then I guess as a supplier, I would never pay the average LMP that you have, for example, listed in your column D on Exhibit 3, would I?

A. Probably not.

MR. McNAMEE: That's all I needed. Thank

you very much.

THE WITNESS: You're welcome.

EXAMINER PRICE: Let's go off the record.

(Discussion off the record.)

(At 12:25 p.m., a lunch recess was taken until 1:30 p.m.)

\- - -

Monday Afternoon Session,

October 20, 2008.

- - -

EXAMINER PRICE: Mr. Hayden.

MR. HAYDEN: Just one question, your Honor.

- - -

SCOTT T. JONES

being previously duly sworn, as prescribed by law, was examined and testified further as follows:

REDIRECT EXAMINATION

By Mr. Hayden:

Q. Dr. Jones, in your examination you were asked a question by the Bench about whether obtaining forward prices closer to the time that an MRO would occur would be better.

Do you recall that question?

A. Yes, in general I recall, yes.

Q. Okay. And can you clarify your answer to that question, please?

A. Well, first of all, it was my understanding the question being asked had to do with the energy component of the ultimate price.

And other things equal, the energy component taken at a date nearer the point in time when the MRO would actually take place would most likely be -- it's not certain -- but most likely would be a better representation of then-prevailing energy prices at the time the MRO was executed, but the assumption is other things equal, meaning that from the point of view of the price a participant in the MRO would bid, you would have to take into account all those other risks that I talked about on a number of occasions this morning which have gone up in my opinion, so that there's not necessarily a correspondence between what I would estimate the MRO price to be and the trend energy price, not to mention the fact even if we do it today, there is a chance the energy price component would be higher today, other things equal.

MR. HAYDEN: Thank you.

Your Honor, I have no further questions.

EXAMINER PRICE: Mr. Small.

MR. SMALL: No questions, your Honor.

EXAMINER PRICE: Mr. Yurick.

MR. YURICK: No questions, thank you.

EXAMINER PRICE: Miss McAlister.

MS. McALISTER: No questions, your Honor.

MS. FONNER: No questions.

EXAMINER PRICE: Mr. Smith.

MR. SMITH: No questions.

EXAMINER PRICE: Mr. Breitschwerdt.

MR. BREITSCHWERDT: No questions, your Honor.

EXAMINER PRICE: Mr. Lavanga.

MR. LAVANGA: No questions, your Honor.

EXAMINER PRICE: Mr. Boehm.

MR. BOEHM: No questions, your Honor.

EXAMINER PRICE: Mr. Bell.

MR. BELL: One question.

\- - -

RECROSS-EXAMINATION

By Mr. Bell:

Q. All other things being equal is the qualifier in your response to the Bench's question. Is that also not predicate for your testimony as represented on page 25, line 2, where you talk about the risk other things equal?

A. Yes, I use that term.

MR. BELL: Thank you.

EXAMINER PRICE: Ms. Wung.

MS. WUNG: No questions, your Honor.

EXAMINER PRICE: Mr. McNamee.

MR. McNAMEE: Nothing, your Honor.

EXAMINER PRICE: I don't have any

questions.

You're excused. Thank you.

MR. HAYDEN: Your Honor, at this time I would move for the admission of Company Exhibit 6, the direct testimony of Scott T. Jones.

EXAMINER PRICE: Any objection to the admission of that exhibit?

Seeing none, it will be admitted.

(EXHIBITS ADMITTED INTO EVIDENCE.)

MR. SMALL: OCC moves OCC Exhibits 8, 9, and 10.

EXAMINER PRICE: Any objection to the admission of OCC Exhibits 8, 9, and 10?

Seeing none, those exhibits will be admitted.

(EXHIBITS ADMITTED INTO EVIDENCE.)

EXAMINER PRICE: Mr. Burk, your next witness.

MR. BURK: Mr. Hayden.

MR. HAYDEN: Your Honor, the companies call Frank Graves.

(Witness sworn.)

EXAMINER PRICE: Please be seated and state your name and business address for the record.

THE WITNESS: My name is Frank C. Graves.

I work at the Brattle Group, 44 Brattle Street, Cambridge, Massachusetts 02138.

EXAMINER PRICE: Mr. Hayden.

MR. HAYDEN: Your Honor, I would ask to have marked for identification the direct testimony of Frank Graves as Company Exhibit 7.

EXAMINER PRICE: So marked.

(EXHIBIT MARKED FOR IDENTIFICATION.)

MR. HAYDEN: I would also ask to have marked for identification as Company Exhibit 7A the response to OCC Set 3 RPD-29, please.

EXAMINER PRICE: So marked.

(EXHIBIT MARKED FOR IDENTIFICATION.)

- - -

FRANK C. GRAVES

being first duly sworn, as prescribed by law, was examined and testified as follows:

DIRECT EXAMINATION

By Mr. Hayden:

Q. Mr. Graves, do you have before you what has been marked as Company Exhibit 7?

A. I do.

Q. And is that your direct testimony in this proceeding?

A. Yes, it is.

Q. And do you have before you what has been marked as Company Exhibit 7A, which is a response to OCC Set 3, RPD-29?

A. Yes.

Q. And could you explain what that is, please.

A. Yes. The latter, 7A, is that what you are referring to?

Q. Yes, I am.

A. Yeah. 7A is a response to the set of interrogatories that were sought from the OCC, and it's specially germane now because in that response I identified an error that occurred in one of my calculations in Exhibit 2, and I provided the corrections which I can describe now.

Q. Okay. Please do that.

A. The original filing of Exhibit 2 in column 8 is a column labeled "Forward Adjustment," and that measures the increase in forward prices from the time of the auctions in column 1 and 2 to the present or to July 15 of this last summer, and it had been previously calculated with the wrong denominator, that is, the percentages were expressed in terms of percentage change as a percentage of the new price as opposed to the old price.

So in the revised exhibit I corrected that, and it makes them all slightly higher because forward prices have generally risen a little bit, so the correct denominator was lower than was originally used.

The net effect, as you see in the last column, that my results for Exhibit 2 are about $7 per megawatt hour higher on average with some difference in the pattern across the individual utilities.

Q. Thank you.

Do you have any additional corrections to your testimony at this time?

A. Just the follow-up where those materials appear in my testimony and on page 15, lines 11 and 12, there are two specific numbers taken from that exhibit. Line 11, the number 76.35 should read 77.55, and line 12, the number 93.80 should read 106.59.

Q. And other than those corrections which we have just talked about, Mr. Graves, if I were to ask you the same questions which are contained in your testimony today, would your answers be the same?

A. They would.

MR. HAYDEN: Thank you, your Honor. The

witness is available for cross.

EXAMINER PRICE: Thank you.

Mr. Small.

MR. SMALL: I am going to retrieve one of those migrating microphones.

- - -

CROSS-EXAMINATION

By Mr. Small:

Q. Good afternoon, Mr. Graves. Jeff Small, Office of the Ohio Consumers' Counsel.

A. Good afternoon.

Q. I have a couple of quick inquiries about your correction sheet, FirstEnergy Exhibit 7A.

A. Okay.

Q. This is not a complete response to the OCC request for production 29, is it? There were other documents promised by this -- by this response to the request for production, correct?

A. Yes, there were workpapers.

Q. Yes. And they are not attached to this, are they?

A. Correct.

Q. Okay. So the correction portion of your -- that you just stated is the portion on the first page labeled B; is that correct?

A. Yes, B describes the correction and then the table that's attached fulfills it.

Q. So the table gives the empirical questions and D describes the corrections?

A. That's right.

Q. The rest of this is not part of your corrections.

A. No. The others were just straight responses to the requests for information.

Q. Okay. Would you please turn to page 14 of your testimony and line 8.

On that line you state a date of July 15, 2008.

Do you see that?

A. I do.

Q. What's the significance of that date for your testimony?

A. That's the reference date for the calculations that I performed, that is, to the extent possible, all the data is contemporaneous to that time frame.

Q. And did you base your testimony on July 15, 2008, because you were instructed to do so by the FirstEnergy companies?

A. In one sense, yes, in that it was

important that my analysis be synchronized with that of Dr. Jones so the results would be comparable so we both used that date.

Other than that, it was just a date that was about the time when we were finishing the analysis, so it was a very appropriate current reference point.

Q. Did you discuss that date with Dr. Jones?

A. No. I did not discuss my report at all with Dr. Jones before it was finished.

Q. So the date came from FirstEnergy?

A. I believe that's right. We agreed we wanted to -- we probably asked them what date we should be using since we had middle of the month analyses and we wanted to synchronize, so they said, hey, let's use the 15th.

Q. Okay, I'm a little bit confused. You are using "we." Are you referring to you and your associates, or are you talking about you and Dr. Jones?

A. My associates and I wanted to make sure we were filing in a time frame that was relevant for the way FirstEnergy's other witnesses were going to file.

Q. Would you please turn to page 7, lines 12 and 13 of your testimony.

A. Okay.

Q. You mention "large amounts of customers switching for the FirstEnergy companies."

A. I see that.

Q. Do you understand that those switching statistics were arrived at after incentives for switching were built into stipulations as part of cases that launched competition in the state of Ohio?

A. Yes, I'm generally familiar with that.

Q. Is there anything in the FirstEnergy proposal in this -- in this proceeding that would tend to repeat that experience?

Is there anything -- any similar type of incentives that would drive customers switching up again the way that happened in the past?

A. I'm not aware of any policy that's attached to the MRO or ESP filing that in any way is trying to promulgate more switching which in that sense is perhaps different than prevailed in the early 2000s. But market circumstances are such now that substantial switching is plausible.

Q. And what circumstances are those?

A. I think the high and volatile prices we've observed could easily change dramatically one direction or the other over the next couple of years and that could induce customers to migrate back and forth between alternative services.

Q. I understand from your testimony that you reviewed auction results from other states; is that generally true?

A. Certainly.

Q. Are you aware that FirstEnergy EDUs have conducted one auction in Ohio and then a second process was begun for the FirstEnergy companies?

A. Generally.

Q. Did you -- did you study the circumstances of the FirstEnergy auction that was conducted in Ohio or the auction that was conducted for customers that would be served by FirstEnergy?

A. Not in close detail. I'm aware that there was one, I believe, in the late 2004. And that's a period that is sufficiently prior to this analysis that I didn't think it would be informative to incorporate in this study. So I know a bit about it, but I didn't study its details closely.

Q. And did you collect any data from that circumstance in Ohio for the FirstEnergy auction?

A. No, I did not.

Q. Did you in your analysis use a capacity adjustment for -- of $2.10 or $2.20 -- .20 per kilowatt month figure? Did you use that in your analysis in particular for preparing Exhibit 2 in your testimony?

A. Yes, that's implicit in column 12 of Exhibit 2.

Q. And did I correctly state the magnitude of it?

A. Yes, I believe it was around $2.20 or $2.25, something like that, per megawatt date.

Q. And you use those figures from FirstEnergy, correct?

A. Yes.

Q. And those are DNR prices for sometime in July or August; is that correct, as you understood it?

A. My understanding is that they are based on transactions in which there were capacity prices for July and August which were materially higher 4 to 5 hundred dollars a megawatt day, but that if you convert those to an annualized basis, it's about $26,000 a kilowatt year, which is consistent with $2.20.

Q. Do you agree that there is quite a bit of subjectivity involved in that concerning what bidders will bring to the process in assessing the risk premium or other kinds of premiums that might be factored into -- into the analysis of generation prices?

A. I assume you are referring to an MRO type fixed price bidding situation or some other context?

Q. I'm referring to the context of your testimony which is, as I understand it, adding premiums in order to come up with your final results.

A. I would certainly agree there is a lot of extra judgment that is involved in my experience with people -- parties that have bid in these kinds of proceedings. It's not a subjective analysis.

It can be done quantitively, but you have to make judgments about ranges of risk and customer behavior and things like that about which there is no certainty.

MR. SMALL: I have no further questions. Thank you, your Honor.

EXAMINER PRICE: Thank you.

Mr. Yurick?

MR. YURICK: Good afternoon. I just really have maybe one, maybe two questions.

\- - -

CROSS-EXAMINATION

By Mr. Yurick:

Q. If you could turn to page 10 of your testimony.

A. Okay.

Q. And if you look at lines 6 through 8, you say "There are reasons to expect that the Ohio Companies' customer-switching risk will be greater than that reflected in the adjusted comparables used above."

Do you see that?

A. I do.

Q. Have you conducted any real life inquiry into the frequency of shopping customers among the companies' customers to determine whether or not in comparison with other customers in other jurisdictions the Ohio companies' customer switching occurs more often or less often?

A. No, I am not relying on a specific assessment of how much more likely it might be in other settings, but it's certainly true from other experience in other states that, for instance, industrial customers have shown a much greater propensity to switch and they are part of the SSO service block in this proceeding.

Q. Okay.

A. And customer aggregation can only help so. And I think that's more prevalent here than it's been in other settings.

Q. As you sit here, you don't know whether that happens more frequently in Ohio than these comparable jurisdictions or not; isn't that correct?

A. I don't have any specific parameterization of how much more it might be likely to occur.

Q. Well, it might be less?

A. It's pretty likely.

Q. It might be less though; you just don't know?

A. It's a problem, but I think it would be a better expectation to believe it would be more.

Q. Well, I understand that, but you -- the fact of the matter is in a real -- in real terms you don't know whether it happens -- it could happen less likely in Ohio; isn't that right?

A. Fair enough, but I guess I'm trying to put myself in the shoes of an analyst who would be worried about this problem as a potential bidder in the MRO process, and from my experience in dealing with parties that like to participate in that sort of service, I think they would take customer aggregation in the industrial mix into account and probably forecast greater propensity to shop than they have seen elsewhere.

Q. Well, sir, if I was -- if I was a forecaster and I was worried about it, wouldn't it be reasonable for me to look at historically what the experience has been?

A. If you had good data and you had the time to compile other sources of information, sure, but many times you rely on surrogate analyses such as what's happened in other states, what's been the history of the state generally without, in effect, refreshing it for very current customer perceptions because that's all you have.

Q. Yeah, but you would have access to the frequency of customers switching data from the company if you wanted it, right?

A. I suspect it's available, but I haven't studied it.

MR. YURICK: I understand that.

I have no further questions.

EXAMINER PRICE: Thank you.

Ms. McAlister?

MS. McALISTER: No questions.

EXAMINER PRICE: Ms. Fonner.

MS. FONNER: Yes, please.

- - -

CROSS-EXAMINATION

By Ms. Fonner:

Q. Good afternoon, Mr. Graves. I'm Cynthia Fonner from Constellation Energy.

A. How are you?

Q. Looking at page 3 of your testimony, lines 14 through 19 indicates that as part of your analysis, you were trying to establish a market price for FirstEnergy's ESP; is that correct?

A. It's phrased that way. What I was actually trying to do is find a market price as a reference point for their ESP but not to explicitly price a market expectation of what their -- an ESP-like service would be worth.

So that I'm trying to find out what a full requirements fixed price product would be worth and then that, I understand, is an input to the consideration of the Commission as to whether they prefer that arrangement to the ESP.

Q. Would you agree that in evaluating whether an ESP is more favorable in the aggregate than a market rate offer, that actually pricing that

ESP product would provide the best comparison between those two options?

A. If the problem at hand were to decide if the ESP is a bargain on its own terms, then understanding it component by component might be very useful, but I understand the problem to be a bit different, which is to compare a fixed price MRO with its risk and procurement characteristics to an ESP with different service characteristics and decide whether the difference in prices is offset by differences in benefits.

Q. Okay, let's talk about some of those differences in terms of characteristics.

At page 17, lines 9 and 10, you indicate "that a charge will be applied to any customer who wishes to leave" -- "customers who wish to leave SSO with the right to return to the fixed SSO price in the future."

Did you consider -- well, first of all, would you consider that an impediment to customers switching potentially?

A. If it were mandatory that, if you wish, you make -- you pay the standby charge, then it would clearly alter the threshold price at which you would be willing to switch because you would have to be compensated for the standby price itself. It's not mandatory, so you can leave and not incur that.

So I think it really creates a risk protection for customers who want to come back and are willing to pay a premium to do so.

Q. The alternative being to come back at the higher of the market price times 160 percent or the higher of the ESP. Do you understand that's the alternative to payment of the SBC?

A. That's one of the alternatives. The other alternative is to not come back, continue to procure on market terms.

Q. And did you factor that SBC potential into your analysis?

A. Well, as I described here, I understood at the time of writing this testimony that it would be applied to anyone coming -- who wanted to leave SSO and then return.

I now understand that that actually only applies to the ESP consumers, that is, if that is the source of the SSO and not if the MRO is the source of the SSO. But with that perception that it affected the SSO departures generally, I incorporated it by suggesting that it would dampen some of the risk.

Q. Are you aware of the fact that SBC charge actually increases in each year of the plan?

A. Yes, I understand that.

Q. And would you expect that that would have an inverse affect on switching in that as the SBC charge increased, switching would be dampened for that particular year? Would you expect that to be the case?

A. Well, again, to the extent it is -- it was mandatory or overwhelmingly preferred, it does make it less profitable to switch until prices have fallen a long ways in the market. And the bigger it is the father -- the longer you have to wait.

But, again, it's not mandatory so you don't have to pay that.

Q. And I want to talk about some of the other components of the ESP. Have you read the ESP itself?

A. Yes, I have.

Q. And are you familiar with rider MDS which is a minimum default service charge?

A. Generally.

Q. And are you aware of the fact that that's nonbypassable? And what I mean by nonbypassable, I mean it's applied to all customers, even those who choose a competitive supplier for their generation?

A. Yes. I understand it to be embedded in the generation charge if you are on ESP, and it becomes a surcharge if you are shopping.

Q. And are you aware of the fact that there is, as part of the ESP, a deferral of generation that, again, is nonbypassable such that customers of competitive providers would be paying for generation used by customers of FE?

A. On returning to service after leaving the shopping, I believe that's correct.

Q. You are not aware of the fact that regardless of whether you are currently taking service from a competitive retail electric supplier, all customers would be required to pay generation deferral amounts?

A. No, I am aware of that. I guess what I was meaning is it's deferred, and so it doesn't happen until after the ESP period that you would start recovering those costs.

Q. You understand that it's possible for a person to be taking generation service and, therefore, paying for generation service from a competitive retail electric supplier during the time of the ESP plan?

A. Sure.

Q. And that the generation deferral component means that later on that same customer will be paying for generation that they did not take from FirstEnergy. Do you understand that component of it?
A. I do. I think I'm trying to say the same thing, it's just a little awkward, there are some amounts that are deferred until after the ESP period, and then everyone pays them whether they shopped or didn't in the interim. That's my understanding anyway.
Q. I think we are on the same page now. Thank you.
And are you aware one of the other aspects is that force of the ESP is to have customers pay uncollectible amounts of generation service from FirstEnergy Solutions -- from FirstEnergy rather?
A. I'm aware of the fact of that. I have no sense of the magnitude or any analysis of it.
Q. And would those factors impact the risks that would be incumbent under the ESP as compared to an MRO?
A. Can you be more specific about whose risks you are talking about?
Q. Sure. Would you -- would you agree that customers taking supply from a competitive retail

electric supplier under an MRO would in some cases -- I'm sorry. Let me strike that.

Would you agree that those particular components of the ESP plan we went through, MDS, SBC, the generation of deferral, if you were to competitively price the ESP would have an affect on that price?

A. I guess I'm still not entirely sure what you mean by "competitively priced," but I agree those affect the way costs would be incurred by FirstEnergy in providing the ESP service and do reduce some of the risks at least with respect to some of those items.

And, of course, they are aware of that themselves and I suspect incorporated in their own pricing of that. I don't know whether competitive pricing would be different.

Q. But you did not -- other than the SBC we discussed, you did not incorporate any of those different risks in your analysis of the MRO; is that correct?

A. No. As I said earlier, I wasn't trying to project the cost of the ESP because, in fact, I wasn't aware of 99 percent of the terms of the ESP nor was it my assignment.

I was supposed to figure out what a fixed price full-requirements auction like service would cost.

Q. Okay. And similarly with respect to certain riders that exist under the ESP fuel transportation surcharge, fuel cost adjustment, and capacity cost adjustment, those are all elements that would decrease FirstEnergy's risk in supplying its customers that supplier under the MRO would not have; would you agree with that?

A. Yes, again, restricting attention to those factors they tend to reduce risks for FirstEnergy in providing ESP. On the other hand, they incur other kinds of risks in the way they have offered it an MRO provider would not incur so there are trade-offs of different kinds.

Q. When you say they incur risks, you are aware of the fact the riders give FirstEnergy guaranteed recovery of those costs, correct?

MR. HAYDEN: Objection, your Honor. At this point the witness has testified that he's -- he's not here to testify on these riders, it's outside the scope of his testimony, and there has been a protracted line of questions here about these riders which he's not here to testify on.

EXAMINER PRICE: Isn't he here to testify as a comparison for the ESP and the MRO?

MR. HAYDEN: Your Honor, he -- he is not testifying on the mechanics or the specifics of the riders themselves which this line of questioning is going to.

EXAMINER PRICE: Ms. Fonner?

MS. FONNER: The heart of this proceeding is to determine whether an ESP is more favorable in the aggregate in the MRO, and as part of that, we need to look at all components, including riders, that apply, including different nonbypassable charges and others, actually do an apples-to-apples comparison and to give you and the Commission a true sense of what is really going to be more favorable for customers and consumers in Ohio in the FES service territory.

EXAMINER PRICE: I agree. Overruled.

THE WITNESS: Can I hear the question again?

(Record read.)

A. I would qualify your description in two ways; one, it's my understanding, again, not perfect and probably better addressed for company witnesses, that the riders don't, in fact, track every variance in every cost item they are associated with.

There are thresholds and delays and various things that don't kick in until certain extreme points or times have elapsed, so they certainly don't give perfect recovery of the factors they're even riding.

Second, I don't know how reliable the rider cost recovery mechanisms are themselves. There may be standards of prudence and reasonableness that are applied to those and or that in principle would arise if they are not explicitly stated now, and I would expect those to not be bulletproof simply because in regulatory processes if something is unreasonable, customers rightly tend to be able to complain about them.

Q. Fair enough.

But these are elements that a supplier under an MRO does not have that cost recovery, would you agree? That they have -- they are expected to bid in all -- in prices that they will have to live with?

A. Yes, I agree MROs are set up -- or this one is proposed and most auctions of its kind are set up to be decided one criteria alone, which is price and everything is fixed as an obligation by design.

The ESP is not like that.

Q. Moving on to some shopping risks, and you discussed this briefly before, but I wanted to talk in a little bit more detail on pages 5 and 6 with respect to government aggregation programs increasing the shopping risk.

A. Okay.

Q. Now, you do not know what -- what percentage of those jurisdictions that have aggregation programs currently in Ohio are actually taking service under that from someone other than an EDU; is that correct?

A. I have not investigated that.

Q. And aggregation in Ohio is -- can be either opt in or opt out, correct?

A. Generally I am aware that that's the case.

Q. So any kind of aggregation would not change overnight but rather through an aggregation program there are certain steps one must go through in order to be qualified as an aggregator.

A. I generally understand that to be the case, but I couldn't tell you how -- the details.

Q. And even if somebody were already certified as an aggregator, you would expect them to do due diligence regarding sending out offers before they actually committed to a supply contract; would you agree?

A. You would hope so. There's been some history of that not occurring.

Q. Assuming people have done their due diligence, you would expect that to be the case.

A. There are certainly some things you would want to investigate. The better aggregators will do so.

Q. And you mentioned some states in terms of comparables and government aggravation programs exist in some of those jurisdictions currently, correct?

A. Yes, there are places where government aggregation goes on. I don't think it has gone in any length to the same extent in regions where I took my data from.

Q. Well, they actually do have government aggregation programs in New Jersey, do they not?

A. I believe so.

Q. And Pennsylvania?

A. I couldn't tell you for sure about that.

Q. Maryland?

A. Yes, I believe it's allowed.

Q. Illinois?

A. Don't know.

Q. And turning very briefly to Exhibit 1, this looks at customers switching generally, not with respect to aggregation specifically; is that right?

A. That's correct, although it's my understanding in Ohio a lot of that has been historically attributable to aggregation.

Q. And the figures that you use here are for 2006, I noticed.

A. Through 2006, yes.

Q. And are you aware of the fact that the most recent switching statistics ending June 30, 2008, would put total sales for Cleveland Electric Illuminating at just over 12 percent, Toledo Edison 12.67, and Ohio Edison 18?

A. Not specifically. I understood they were down, but I didn't know the numbers.

Q. Turning to Exhibit 2 now, if you would, you include a capacity price adjustment in column 12, I believe.

A. That's correct.

Q. And did you make that based upon the capacity prices that exist on the day these particular procurements were run or the capacity prices that existed based upon the delivery period?

A. Well, it varied because in some cases there was in PJM's circumstance an RPM price that prevailed and prescribed the future, and when that was available, I used it for the early auctions.

In 2006, for ComEd in particular there was no UCEP -- I mean RPM arrangement in place yet, and so I used historical UCAP prices for that.

Q. With the exception of Illinois, you would have used whatever the prevailing capacity price was on the date the event was run?

A. Yes. They don't -- they are not daily, they don't change daily in the RPM world but, that's right, the price that is prevailed for the future years at the time of those auctions.

Q. And other than Ameren, are the rest of those EDCs part of PJM?

A. Yes.

Q. And you spoke about the RPM market which was new in 2007, correct?

A. Yes.

Q. And you would agree there was some uncertainty prior to that time of what the results of the new capacity market would be?

A. Sure. Up until the day it's -- the auctions occurred -- I mean -- yes, the auctions occurred, then you didn't know the prices.

Q. And it's only very recently that the RPM auctions actually are three years forward looking. In the initial auctions it was only one planning year.

A. That's correct, and then they added a couple more six months later installments. They worked out to three years ahead.

Q. When I say "planning year," you understand I'm referring to June 1 through May 31?

A. Yes.

Q. And the schedule for RPM for -- was as follows, if you recall, April, 2007, for the 2007/2008 planning year; May, 2007, for the 2008/2009 planning year; October, 2007, for the 2009/2010 planning year; and February, 2008, for the 2010/2011 planning year.

Would you agree that was the schedule of the -- of those initial RPM auctions, subject to check?

A. That sounds right.

Q. So when these initial auctions were held in looking at the ComEd up through the first Rockland, those would have been run prior to the first RPM auction, correct?

A. Yes, that's correct.

Q. So you don't know what bidders in those auctions assumed the capacity was going to be in submitting their prices, do you?

A. No, not explicitly. We assumed they were guessing on the basis of what occurred.

Q. And you talked about the -- as with Mr. Jones, you used July 15, 2008, for purposes of your calculations, correct?

A. Yes, for the forward prices.

Q. And since that time forward prices have come off rather dramatically; would you agree?

A. It varies by horizon. The near term forward prices have fallen off a fair amount in PJM, less so in Cinergy, and less so in out years than the current year.

Q. And specifically for 2009, the Cinergy peak has dropped approximately -- has dropped 17 percent, in the PJM approximately 29.5 percent; is that what --

A. I haven't calculated it in percentage terms but that's plausible.

Q. And there has been a continuous trend downward since July 15; do you agree with that in terms of the forward prices?

A. Again, speaking highly averaged level of annual strips, I suspect that's true. There may be some months it has gone up over the course of a year but on average I think whole year strips are down again more so than the near year than for out years.

MS. FONNER: Thank you. I don't have anything further.

EXAMINER PRICE: Thank you.

Mr. Smith.

- - -

CROSS-EXAMINATION

By Mr. Smith:

Q. Good afternoon, Mr. Graves. My name is Craig Smith. I'm representing the Material Sciences Corporation, an industrial customer.

In your testimony you describe the assignment and in performing your assignment were you looking at this from the perspective of FirstEnergy operating companies or the suppliers to the FirstEnergy operating companies?

A. Really neither. I was just asked to investigate what a -- an unidentified qualified player in the market would probably think an MRO price ought to be as of the middle of the summer. It wasn't with an eye to what any portion of FirstEnergy might think about it.

Q. Who's assuming the shopping risk; the supplier or the standard service offer provider in your analysis?

A. My analysis is agnostic as to how the supplier will cover his obligation. It might not cover it at all. He might buy spot power and just take his chances on being able to sell it at a fixed price, and then he is responsible for the risks incurred in that way, or he might buy it with flexible upstream contracts so my perspective is entirely from the point of view of the standard service offer provider stuck with the fixed service sales, fixed price sales.

Q. And do you not agree to the extent the SSO provider assumes risk depends on the tariffs between the provider and the customers?

A. Certainly and, again, I have analyzed it under the perspective of the prices being appropriate to a fixed price full-requirements service whose prices don't change, and the only tariff-like adjustment that I have incorporated in my analysis is the -- my overly generalized understanding there would be a standby charge for all SSO customers if they switched and wanted to come back. That turns out to not be true. It only applies to ESP customers. But other than that, I'm treating it as a fixed price full requirements service.

Q. And the primary risk that you perceive is committing by contract to purchasing electricity and having customers migrate to other suppliers through shopping?

A. The primary risk to the SSO supplier; is that your question?

Q. Yes.

A. That's certainly a very large risk. I wouldn't say it's the only risk but that's one that is a big factor.

There's other risks associated with the uncertainty costs of load balancing as you try to react to shapes that aren't exactly what you expected. There is credit risk. There's regulatory rule changes. There's lot of things that can happen, but customer switching is a significant one.

Q. In doing your analysis you essentially developed three exhibits. Exhibit 2 determines comparables.

A. Correct.

Q. Okay. And in your direct testimony you introduced revised Exhibit 2, correct?

A. In my answer to the interrogatories -- and I guess just now I also introduced it, yes, that's right.

Q. This Exhibit 2 that you provided through interrogatories, does this replace the Exhibit 2 in your prefiled testimony?

A. Yes.

Q. Now, how did you determine the average price of $95.13 as your adjusted result?

A. At the bottom of column 14, that's what you are talking about?

Q. Yes. Just the method.

A. It's simply a weighted average -- I mean, an arithmatic average of the numbers above it.

Q. Okay. Now, in your prefiled testimony you did not provide an average.

A. No, that's true.

Q. Okay. And you did not think it was important to average the numbers in the prefiled testimony?

A. The reason I'm providing an average here is to show the overall affect of the change of the correction I made.

I guess an average is interesting, although I think the more interesting takeaway from this kind of analysis is that there is potentially a fairly wide range of uncertainty regarding what these prices will be and it depends on the bidders' perception of the circumstances at the time as to how much of a premium they would impose, and so I wanted to provide the range more than a spot estimate.

Q. Well, with your revised Exhibit 2, when you go to page 15 in your testimony, you provide a range of numbers.

A. Yes.

Q. Are those numbers still accurate on page 15, lines 10 through 14? Or did they change because of your revision -- revised Exhibit 2?

A. The numbers on lines 11 and 12 did change as I stated when I was giving the errata to my testimony.

Q. Okay, would you please tell me again.

A. To restate those for you, sure. The first one of $76.35 goes to $77.55, and the second one goes to 106.59.

Q. Thank you.

You also performed a modified constructed cost. Now, is your model similar to the previous expert witness Jones' testimony about determining direct costs and then determining risk?

A. Yes. The basic concept is the same. We adjust for risks slightly differently, but we are fundamentally doing the same analysis.

Q. You did not come to exactly the same answers.

A. That's correct.

Q. Okay, and that's because of different adjustments for risk and also perhaps different timing periods? I mean --

A. Certainly a substantial component is the way we adjusted for risk, there may be some other nuisances as to exactly precisely what data he was relying on to what I was relying on.

Q. Do you not agree the risk adjustment is really that perceived by the -- well, for Dr. Jones it was by the supplier. And your risk analysis adjustment would be as perceived by the SSO provider, correct?

A. I don't think Dr. Jones and I have a distinction in mind as to who is bearing the risk. Maybe you and I have a semantic issue that's arisen. I'm talking about the risks falling on the provider whose responsible for guaranteeing the power at a fixed price, and I was calling that the SSO provider.

Maybe you are calling the companies the SSO provider, and they are procuring it through MRO or ESP, let's call the MRO winner the supplier and then that's who I am talking about.

Q. So both you and Dr. Jones are talking about the MRO winner?

A. Correct.

MR. SMITH: I have nothing further.

EXAMINER PRICE: Thank you. Mr. Breitschwerdt.

MR. BREITSCHWERDT: Thank you.

\- - -

CROSS-EXAMINATION

By Mr. Breitschwerdt:

Q. Good afternoon, Mr. Graves -- or Dr. Graves. My name is Brett Breitschwerdt, and I have a few questions on behalf of NOPEC, which is the largest governmental aggregation in the state of Ohio.

A. Sure.

Q. Earlier when you were responding you made a response to a question from counsel for OCC about a 2004 FirstEnergy auction, and you said the 2004 period was sufficiently prior to this analysis, which I understood you to mean in your testimony that you

did not think it would be informative.
Do you remember making that statement?

A. I do, yes.

Q. Well, I guess my question to you then is your analysis of governmental aggregation in Ohio and outside, what is the time period of that analysis -- let's start with in Ohio -- what is the time period of that analysis in Ohio?

A. Well, that's a bit of a mischaracterization of my testimony to say I have done a study of aggregation in Ohio and its history.
I understand from PUC documents, I believe, that in around the 2002 and '3 period there was a very successful process of aggregation that some 90 or 95 percent of customers who did switch were participating in aggregation programs, and the switching reached levels of 30 to 40 percent on average and some cases 60 percent, I believe, below the Ohio Edison's territory as I recall.
And that's -- and that there still is an active process there with organizations such as your own but that's about the extent of an empirical study I did.

Q. So that would be the extent of your analysis of governmental aggregation was shopping generally, I guess you say; is that fair to say?

A. Yes. I am not relying on a specific belief about how well it's going to work and precisely what the rate of aggregation or switching will occur.
I'm just observing that there are structures in place and they have proven successful in the past at creating a great deal of switching.
Q. Okay. Regarding your Exhibit 1, if you could turn there, please.
A. Sure.
Q. Just for my clarification, I looked at this and, honestly, I couldn't tell which of these lines was the Ohio FirstEnergy companies, the analysis.
A. You have a black and white copy.
Q. I do.
A. It's the highest one.
Q. Okay, so starting in 2000 and ramping up to the approximately 35 percent until 2005, and it looks like a pretty steep decline at that point starting in 2005; is that accurate?
A. I see that, yes.
Q. Do you -- in your analysis did you assess the significance of that 2005 point where there is a sharp decline in the amount of, I guess, shopping

generally?

A. I have a suspicion what's causing it, but I haven't studied it or, you know, related it to a specific individual customer's decisions. But there was a marked spike in power prices in late 2005 in response to, for instance, the influence of Hurricane Rita and the prices shot up substantially, and it's plausible that the market base services being offered by aggregators no longer looked as attractive as the rate stabilization plan prices of companies like FirstEnergy.

Q. So this I guess sharp decline in shopping generally and participating in aggregations didn't necessarily form your analysis going forward of the action of participation in governmental aggregation; is that a fair characterization?

A. Well, let me reinforce that. I'm speculating precisely what went on there, but to the extent that is a response to the sudden appeal of the RSP prices compared to what was being offered by aggregators, it in a way proves my point that anybody who is supplying an MRO product has to be quite concerned about customers migrating quickly back and forth if market circumstances become unfavorable relative to the regulated or a fixed price alternative, and it can happen -- you can lose money going both directions.

So the high amount of volatility in customer shopping is a risk factor that I did take into consideration.

Q. So -- so taking that forward to the proposed ESP starting in 2009, your testimony on page 17 does address your understanding of what a -- is it fair to characterize it a market-based analysis what the ESP price would be over the next three years in $92 and $90 per megawatt hour?

MR. HAYDEN: Can we have it reread, please.

(Record read.)

A. The 92 to 90 dollar range is not -- there is two clarifications I would like to make; one, that's not a forecast for the ESP, that's a market reference price, an MRO-type price to which the ESP could be, and its different service characteristics can be compared. So I think that's a likely MRO price, at least it was as of July 15.

Does it take into account the switching behavior that we just discussed on Figure 1? Yes, I guess so, in that it's based on believing a certain minimum risk premium is likely to be observed in the

MRO.

And I made a judgment about what that would be based on with the history, but it's not explicitly forecasting a degree of switching. It just says that switching looks high enough to merit a substantial risk premium.

Q. So did you analyze the actual ESP plan in coming to this 92 to 90 dollar market-based price and the implication that would have on switching?

A. No. This is not an attempt to lay my guess of ESP against this forecasted MRO price and decide that merits a certain amount of switching risk premium.

I'm simply saying if I was a customer -- I mean, a supplier bidding in an MRO process over the next three years, I would expect to offer my services at around $92 to $90 a megawatt hour.

I put them in that order because I think it would decline slightly over time and that would incorporate a risk premium for me to be able to cope with the amount of customer switching history suggests possible.

Q. Okay. Talking in generalizations, would that also hold true, this price that you propose for a third-party supplier that would be considering contracting to serve the load of a large governmental aggregation such as NOPEC, the organization I represent?

A. It applies to a slice of system, so if NOPEC was to go out and take on an equal percentage of every load class or happen to aggregate in a town which was cross-sectionally pretty much like the entire load mix of these customers, then, sure, that might be a price that a NOPEC analyst would also think is a reasonable price to offer going forward.

Q. Okay, and based on the fact NOPEC's load is residential and commercial customers, how would that, general speaking, generally I understand you haven't done the analysis, how would this impact the 92 to 90 dollar megawatt price? What would it make it go up or make it go down?

A. It's tough to do say without doing an analysis. I think there is two offsetting affects. One is it sounds like you would be restricting your market to customers who are less likely to switch than the industrial base that's a substantial portion of the slice of the system. So that would tend to decrease the risk premium.

On the other hand, you would be working with customers whose load shape would be less flat and more exposed to peak prices and so there might be an increase in the expected costs for load shape differences, and I don't know which would dominate.

Q. Okay. But regardless that -- the price you propose as market based is higher than the price the companies are proposing under their electric security plan option; would you agree with that? Okay. Strike that. Let's walk through it just quickly and I'll move on.

For 2009, do you know what the company's proposing their full requirements SSO price to be?

A. I know the generation component of it is $75 before the deferral and that would be 67.50 with the deferral.

Q. Okay. Well, let's use that as the hypothetical we are working, 67.50. Ms. Fonner spoke with you earlier about the minimum default service rider.

Do you recall that?

A. Yes.

Q. And so that would be a nonbypassable charge of $10 per megawatt hour or 1 cent per kilowatt hour that perspective third-party supplier that would be coming to serve a load of a large governmental aggregation would have to incur -- the price to make a contract successful would have to be lower than 57.50; Would you agree with that?

MR. HAYDEN: Can I have that question reread back, please.

(Record read.)

Q. Sorry. I can --

A. I think I understand your question, and I believe that's correct, that for me to -- first switching, I would have to -- I don't gain any advantage unless I can save more than $10 because I'm going to pay the $10 as an MDS charge if I go shopping, so I need to be $10 below the generation component.

Q. Okay. And that would be for a full-requirements product that would be equal to what the companies' SSO product would be; is that -- would you agree with that?

A. I am not sure what you mean by "equal to," but it would cover your power requirements to the same extent.

Q. All right. So it would cover the same risk, it would include all the direct components that the companies' SSO price would, transition capacity; is that correct?

A. I think that's correct but that's getting into a little of the details of the ESP at a level I may not be the best spokesperson for.

Q. Just one more question.
Based on your analysis of the marketplace can you tell me whether a full-requirements product as the way we have just discussed it whether it's feasible to find this product in the -- in the current electricity market for $57.50?

A. Well, it is certainly inconsistent with my analysis that would be prevalent out there. At least as of the middle of the summer that would be an extraordinary price which I guess is part of what has to be considered the ESP is being offered under terms that are low relative to these numbers but with other arrangements added to the deal.

It's not strictly comparable to the MRO because not everything is fixed, but in exchange it offers other benefits.

Q. But wouldn't that impact the amount of switching that would occur?

I guess what I am saying, the governmental aggregation can't get price below $57.50 from a third-party supplier, how are they going to provide to their customers a benefit to take service from a third-party supplier as opposed to taking service from the companies' SSO price?

A. Sure. Well, you wouldn't expect on day one that the ESP would be set up to be any better than anybody else could do anywhere else either. They are both based on market circumstances but over -- and so they ought to have about the same value but different terms.

On the other hand, over time circumstances can change. Once you have locked down a price, whether it's 57.50 or 67.50 minus 10 or something else, if the market prices fall a lot, then it can become attractive then to switch, so NOPEC might find itself not able to provide a bargain right away but potentially it will provide a bargain, and they may also be selective subsets of customers who can be carved off who have lower risk than the slice of system generally, so they can be offered service at another price.

There is more than one way to participate in the market, but it -- I wouldn't expect there to be a big opportunity right away, that's for sure.

Q. Okay, right away based on your analysis of the quote/unquote marketplace for the full-requirements product anywhere between 2009 and 2011, would you think that opportunity would arise?

A. Well, there has been a great deal of discussion this morning about the fact that forward prices have fallen a lot even since July 15, and while it's not plausible to speculate they will continue to fall, it's certainly possible that they would continue to fall and so that -- and they've fallen enough that it -- I could see alternative services getting interesting in the near future, so I would say never say never.

Q. So there's a slim chance.

A. I don't know. I don't know how slim.

MR. BREITSCHWERDT: Fair enough. That's all I have. Thank you.

EXAMINER PRICE: Mr. Lavanga.

- - -

CROSS-EXAMINATION

By Mr. Lavanga:

Q. Good afternoon, Mr. Graves. My name is Michael Lavanga. I'm an attorney for Nucor Steel Marion. I just have a couple very quick questions for you.

A. Okay.

Q. Can you turn to your Exhibit No. 4, please.

A. Okay. I have it.

Q. Okay. I'm looking at the capacity prices on the second line for 2009, 2010, and 2011.

A. I'm sorry, line 2?

Q. Yes, I'm sorry.

A. Yes.

Q. Line 2 there are three values there, capacity prices or capacity costs for 2009, 2010, and 2011.

A. Yes.

Q. Where did you get these prices again, this capacity costs?

A. These are the same capacity prices we discussed earlier. FirstEnergy supplied to us their recent experience in capacity contracting, which I believe was based on a transaction in early July. And it involved prices that involved capacity payments in July and August only of around $420 per megawatt day or something like that as I recall, and higher pricing in 2010 and '11, and when you convert those to dollars per megawatt day this much load, it's $69.07 and so on.

Q. Okay. And who at -- who at FirstEnergy provided you with this information?

A. I believe it was Mr. Warvell.

Q. And have you made any independent

estimates aside from the information you received from FirstEnergy?

A. No, I have not. We wanted to use a market estimate -- a market price to describe what people were actually trading at, and we understand that's what this is.

Q. And if I heard correctly in response to questions from Mr. Small, you said that this 69.17 price in 2009 converts to a price per kilowatt month of about $2.10?

A. Yeah, $2.10, $2.20, something like that, I believe that's right.

Q. And would you, subject to check, that the 82.50 in 2010 would convert to a dollar per kilowatt month price of about 2.51?

A. That sounds about right.

Q. Okay. And the 95.45 in 2011 would convert to a dollar per kilowatt month price of about 2.90; is that correct?

A. Subject to check, that certainly sounds plausible.

Q. Okay. And then the average of these three months would be about $2.51?

A. Yes, that's my understanding.

Q. And then if I'm correct, on line 3, you increase this number by the reserve margin, which is 13.5 percent?

A. Yes. The capacity is grossed up by 13.5 percent reserves. The peak is. And then you multiply those and get row 4.

Q. Okay. So if I were to take the $2.10 dollar per kilowatt month price for 2009 and applied the reserve margin, I would get $2.35 a kilowatt month?

A. I'm sorry, could you say that again?

Q. If I were to take the $2.10 dollar per kilowatt month price for 2009 and applied the reserve -- the reserve margin, that would get me to about 2.39 or 2.39 per kilowatt month for 2009? Converting it back to an effective price for the amount of loads, not for the load plus reserves; is that what you are doing?

Q. Well, what I'm trying to do is apply the reserve margin to the dollar per kilowatt month prices that we just ran through.

A. Oh, okay. So you are just grossing up the prices by 13-1/2 percent.

Q. Exactly.

A. Yes, exactly.

Q. 2.39 for 2009 or 2.85 per kilowatt month for 2010?

A. I haven't done those calculations but I believe you.

Q. Okay. And then doing the same thing for 2011, you are looking at about $3.30 kilowatt month.

A. Okay.

Q. Okay. And then subject to check, that would average out over the three years to about 2.48 per kilowatt?

A. That sounds about right.

Q. And would you agree with me those are only the costs of capacities and that doesn't include any energy costs for operating the capacities or supplying any energy?

A. Certainly.

MR. LAVANGA: That's all I have. Thanks, Dr. Graves.

EXAMINER PRICE: Mr. Boehm.

MR. BOEHM: Yes, your Honor. Thank you.

\- - -

CROSS-EXAMINATION

By Mr. Boehm:

Q. Mr. Graves, my name is is David Boehm, and I represent the Ohio Energy in this case. Mr. Graves, were you in the room this morning when

Dr. Jones -- thank you, when Dr. Jones was on the stand?

A. Yes.

Q. Okay. I take it that you would then agree with Dr. Jones that given some qualifiers, it is the bare bones market price, if you want to call that -- call it that, is more indicative of what the MRO price would be if and when it's triggered is the date that price gets closer to that -- to the MRO? That's very clumsy.

That an October 10 price would be more indicative of what the MRO price -- price would be than, say, July 15, just because it's closer in time, all other things being equal?

A. I need to be a little bit more careful about what you mean by "an October 10 price."

Q. Okay.

A. We've discussed the fact that forward prices for energy have gone down since July 15 but a lot of other circumstances have changed in ways we haven't quantified.

You would certainly need to quantify every one of those factors if we wanted to try to get a refreshed estimate. And it's not -- many of them would be quite difficult to do.

It's also not clear whether we are in a period that might shake out in a way that two months from now current prices aren't -- in such a fashion that current estimate isn't very indicative of what will eventually happen.

Q. Okay. A couple of things now, Mr. Graves. The other things that you need to quantify are things that you've attempted to quantify and Dr. Jones has tried to quantify with respect to the July 15 information; isn't that right?

A. Yes, you need to quantify everything on the page as well as any other --

Q. Those -- excuse me.

A. -- peculiar to current circumstances.

Q. And those are difficult to quantify now, aren't they?

A. Sure. I think there are three or four things that would be very difficult to quantify now almost certainly are more expensive than they were at the time, but I don't know precisely how much.

Q. The one thing we wouldn't have to estimate with respect to October 10 is what the price was on the board, right? We would know that.

A. The price on the -- I'm --

Q. The price in the marketplace, the bare bones market price we will call it, we wouldn't have to estimate that; we would know that?

A. We would know where the forward curve is to the extent that is visible over the entire term. In fact, it isn't very liquid out very far and so it becomes less meaningful as you go out two, three years out, but we would be able to see the changes in front end for sure.

Q. Well, you don't disagree with Dr. Jones that the Cinergy hub is and continues to be a liquid market though, right?

A. I agree with that, but just generally there is less trading in distant futures than there are in near term futures, and I haven't looked at whether future volumes have become even thinner in response to the credit crisis.

Q. Are you familiar with gas prices at all, Dr. Graves?

A. Not at the level of a trader but I certainly know generally their history.

Q. Are you familiar with where gas prices are right now? Henry Hub, ballpark?

A. To a first approximation, yes.

Q. Ballpark where?

A. $8 a million BTU goes outs.

Q. You think they are $8?

A. That's a ballpark. I haven't looked at it for a while. Are they better or worse?

Q. You need to check them. It's 6 and change.

A. Okay.

Q. Okay. Would you agree with me, Dr. Graves, that in the marketplace in many, many hours -- in relatively many hours of the -- of the day the price of gas sets the price for power, for electric power?

A. I think you need to be careful about what market region you are looking at. It's more true in PJM than in MISO, and it's probably more true in eastern PJM than in PJM in generally.

It's true the gas is on the margin to the greater extent of its share of energy, but it's not a very big share of energy in MISO, so I wouldn't expect it to be the dominant in MISO. It's only about 27 percent in the margin PJM, which is a lot more gas than MISO.

Q. But it tends to set the margin. When we talk about "the margin," we are talking about on-peak hours, right?

A. Well, that wasn't what I was meaning.

Usually on the margin means just price setting, whether it's on or off peak.

Q. Then would you agree with me that it sets the margin more on peak than off peak?

A. Yes, I would think that's true.

Q. Would you agree with me those tend to be the higher prices?

A. Sure.

Q. Yeah. Would you agree with me as a general matter, Mr. Graves -- is it Dr. Graves?

A. No, Mr. Graves.

Q. -- Mr. Graves, that in times of economic downturn parties tend to conserve natural gas?

A. I have no reason to disagree with that. People are income constrained, they would consume generally less of lots of things.

Q. Would you then expect that in times of economic downturn, the price of gas would fall?

A. In the short run, generally I would. But, of course, prices depend on supply and demand and developers also tighten their belts. And if they tighten their belts faster than the customers do, then prices can rise.

Q. If you would take it as a hypothetical that -- let's take as a hypothetical that prices of

gas and just four or five months ago let's assume they were around 13 or 14 bucks an M?
A. Yes, I am aware of that.
Q. They are around 6 and change right now. Would you see any correlation to that and what's happening in the economy generally?
A. Certainly in a pure statistical level, yes, it's obviously correlated. Things are soft and energy prices are down. Oil prices are down. The causal relationships are a little more complex, so some portion of that is coming from oil prices, some portion probably because of resession, some perhaps because of fears of pending collapse in the market and gas being priced on a forward-looking basis if there is fears about the future, they could be driving it down for reasons that haven't even materialized in the current economy.
Q. And we know, do we not, from our conversations this morning, that the price of electricity has been trending down; isn't that right?
A. The energy component of the near-term forward prices have gone down, yes.
Q. And do you have any personal opinion, Mr. Graves, as to whether or not predictions, that I am sure you have here as I have, about a coming

recession, do you put any stock in those?

A. I think that's increasingly the consensus opinion of professional economists and it's not my specialty but people I respect seem to believe that it's likely.

I don't know that you can, again, per se convert that to a presumption of ongoing declining prices because it affects both supply and demand and it's not at all clear which is going to be more effective.

Q. But certainly, Mr. Graves, if you had to do your analysis over again, not -- and I respect the fact you had July 15 at the time and you had to do it from this point forward and you saw all of these things happening, one way or another you would have to factor those into your projections, would you not?

A. Sure, if the task was to restate the analysis on a current basis, I would take all of those factors into consideration and I would try to make adjustments for other changes.

Like I'm confident there is increased risk aversion, probably higher risk premiums is associated with people's willingness to participate in this sort of transaction, maybe a smaller amount of absolute participation that would occur at all in willingness to supply this kind of power. You would -- so you would have to take all those into consideration.

Q. I'm not sure at all whether this relates, but I would like you to go to your revised exhibit that you had.

A. Okay.

Q. And that was your revised Exhibit 2.

A. I have it.

Q. And I am not sure I understand, Mr. Graves, column 8 adjusted from change in forward prices from auction date to July 15, 2008. Could you explain that to me?

A. Sure. Column 2 describes the date at which the various auctions transpired, and they were for services starting in column 4.

So at the time of those auctions there was a fowrard price for power at some nearby hub, for example, for ComEd, the Northern Illinois hub power was trading forward at the time, and we have public data on what the price of the calendar strip was beginning 1-1-2007 to the end of that year.

Now, we are wondering how much different prices are by July 15, 2008. So we go back to the Northern Illinois hub and we find out what the average price of the 12-month strip is on July -- from August 1 to the end of July and compare that price to the price that it had back on September 5, 2006, and it turns out to be 14.27 percent higher, and so I'm moving up the result in column 6 for the change in forward prices since that day.

Q. And if you were required, Mr. Graves, to do a calculation of more recent date, then you would make the same sort of adjustment from your numbers as of -- as of July 15 to whatever the current date would be?

A. Yes, you could do that.

Q. So those numbers could be -- could be a negative number; is that correct?

A. It's possible for some of them.

Q. Yeah.

A. Certainly not all of them but some of them.

Q. Okay. Now, I may be misquoting you so please correct me. I thought that in your discussion or colloquy with counsel for Nucor that you at one point said, well, you couldn't expect the ESP to be better than the MRO starting off.

Did you say something like that?

A. Yes.

Q. Okay. And would you explain that, why you wouldn't expect the ESP to be better than the MRO starting off?

A. Sure. The MRO prices that I've tried to estimate and Dr. Jones has estimated and that prevailed in these kinds of trend -- auctions in the past are designed -- are constrained to be a certain kind of service, it's a fixed price service where for full requirements and the supplier takes all of the procurement and delivery risks associated with doing so, and so there's certain kinds of risk premiums and so on built in.

The ESP as I understand it by design not quite an equivalent service, it's not intended to be a full requirements fixed price nothing ever changes service because if it were, they could just participate in it -- just hold an MRO and FirstEnergy could bid to be a supplier in that and we would find out what the best price was for that kind of service and we would be done.

That isn't what happened. Instead it's set up to describe a different kind of service which has various kinds of commitments to the future, various kinds of associated other benefits, various kinds of adjusters, riders and the like, and various kinds of risk protections built into it.

And in exchange it has a very different price, but all together if you -- if FirstEnergy was doing its homework on the date it offered its ESP price and that date was the same as Dr. Jones and I were doing our MRO estimates, the present value of what the two offers ought to be worth ought to be about the same thing.

That isn't to say the cash payments wouldn't be identical under the two because they are not designed to provide the service in exactly the same way.

Certain kinds of risks are transferred in one case more to customers than others and the other case they are borne by the supplier, so you pay for it under the MRO and flow it through the ESP and the result is a different price. But it doesn't mean it's a different value.

Subsequently, market conditions can change and an MRO being offered at a different date can have an inherently different base because market circumstances have changed.

But that wouldn't tell you -- you couldn't have expected that on day one that it would turn out to be better than the ESP or worse than the

ESP.

MR. BOEHM: Okay. Thank you. I think that's all, your Honor. Thank you.

EXAMINER PRICE: Thank you. Mr. Bell?

- - -

CROSS-EXAMINATION

By Mr. Bell:

Q. Just a few questions.

A. Okay.

Q. Is it correct, Mr. Graves, that both you and Dr. Jones and Dr. Vilbert all engage in a mathematical averaging approach to identifying the requirements of FirstEnergy, be it in terms of return or be it in terms of the market price?

MR. HAYDEN: Objection. Mr. Graves cannot testify as to what Dr. Vilbert or Dr. Jones did in their calculations.

EXAMINER PRICE: Sustained.

Q. Mr. Graves, it is correct, is it not, that you have engaged in an arithmatic computation to quantify the perceived risk premium required by a provider of last resort?

A. Yes, that's correct.

Q. And would you agree that the -- that that risk is peculiar to the individual and the perceptions held by that individual at the time the risk is undertaken?

A. I agree that different participants could perceive those risks differently, but if there were a competitive process, there would be the participant who had the most optimistic release about it would prevail and then it would be an objective feature of their price.

Q. But in any event, the measurement of the risk is taken at the time the risk is assumed, is it not?

A. To a first approximation. There is a little time to do the analysis and then, you know, a day or a few days after that the transactions occur that are being priced, but as close as possible.

Q. Let me put it this way, Mr. Graves, if -- if I'm undertaking a risk today, is not my perception of the risk dependent in large measure upon the duration over which that risk extends?

A. Certainly a factor.

Q. And is not my perception of that risk based upon conditions as they exist and as they may influence my perception at the time I undertake the risk?

A. Well you are -- your willingness to participate in the transaction and your -- or the compensation you require for being exposed to that risk is a special assessment.

If you're eccentric in that belief compared to other market participants, you might be foreclosed from being in the transaction, but everyone comes with a different perception of the key factors.

Q. Are you saying then that risk and the difference in risk is in the mind of the risk-taker at the time the risk is undertaken?

A. It's kind of a hugely general question. Maybe it could be more. Of course, if you were to ask me about a specific type of transaction and a specific circumstance.

Q. I take it you can't answer the question as posed?

A. I think that might be right. Yeah, I can't get more specific without you being more specific.

Q. I think Mr. Boehm touched on it and some previous counsel, and I am now walking down the same path with respect to the credit markets currently freezing up, as I believe Dr. Jones expressed.

Do you have any opinion as to the duration of the economic downturn that we are now experiencing and what effect that will have upon the risks as you have attempted to measure them?

A. I have a suspicion but I'm not a macro economist who specializes in the financial sector, so it would not be maybe many of your own views on it, but I think we will face a problem of some length, two to three years, to work through, and I suspect it will substantially increase the price of risk and the cost of credit for the next -- certainly the next several months as we work through gaining -- regaining confidence in the market.

And then maybe by, you know, next spring or sometime, we'll have more confidence and we will be trying to encourage transactions with highly discounted interest rates and so on, again, but I think that's months away at least.

Q. I take it then you do not share the opinion articulated by the Chairman of the Federal Reserve today that he expects the current problems to persist for some time suggesting that maybe Congress ought to even consider another stimulus package and that he's leaving the Federal Reserve door open for another rate reduction?

MR. HAYDEN: Objection. I move to strike that entire question from the record.

EXAMINER PRICE: Grounds?

MR. HAYDEN: He's not here to testify on what the Federal Reserve Chairman is saying on current events, nor also he's assuming facts that's not in evidence.

EXAMINER PRICE: Sustained.

Q. (By Mr. Bell) My point being this; would you agree that economic conditions are going to cause a retrenchment on the part of consumers and businesses alike?

A. In general I would expect business activity to slow down. I am not sure that's the same thing as a retrench. But I do think that's likely for several months or a couple of years, so I'm -- I think we are in agreement on that.

Q. And if, in fact, that occurs, will that have an impact upon cost of commodities, such as gold?

A. Gold --

Q. Natural gas is suggested by Mr. Boehm.

A. Well, we discussed that it will, but the effects are complex, it could certainly reduce demand, but it could also reduce supply and ultimately switch over -- for those that is reduced more will have the dominant affect on price, and my concern in the context of the Commission thinking about the MRO prices, either now or in the future, would be that those pressures, while they may be pushing energy down, it may be pushing up costs of other difficult to quantify like risk premiums.

The cost of credit, even the ability to participate in auctions and the net effect could be that prices go up for those kinds of services --

Q. I apologize, I didn't mean to interrupt you.

You've not attempted to quantify those risks, have you, Mr. Graves? You are just saying they are offsetting risks?

A. That's correct, my analysis is dated July 15. We weren't in this situation at that time.

Q. So that while from a current perspective in perceiving one's risk out into the future, the economic retrenchment that we are witnessing and have witnessed in the reduction in commodity costs show lost supply and demand; less demand, the prices go down, supply comes up, you acknowledge that that's happened, but offsetting that are other undefined risks, I take it, that you have not measured?

MR. HAYDEN: Objection. That's a mischaracterization of what he testified.

Q. Have you measured those other risks, offsetting risks?

MR. HAYDEN: Your Honor, I have a pending objection.

EXAMINER PRICE: I think he rephrased his question. His second question is unobjectionable.

A. No. As I said, my analysis is the only analysis I have done is the analysis in my report and that describes midsummer conditions, and the best I can offer you now is to comment on the direction that I think those other factors may have and some of them are very difficult to measure, because part of the problem is very poor liquidity and some of the very factors you would otherwise rely on to estimate prices, so there's not as much to observe that you would need to incorporate those into an analysis.

Q. Ignore known price changes on the basis of unknown future risk; is that the essence of your testimony, Mr. Graves?

A. No. The essence of my testimony is I developed an analysis centered on the middle of the summer and the ESP service was offered under the same circumstances and the same set of prevailing economic beliefs, so there's very useful data available here to think about whether the cash differences in the cost of those two proposals are commensurate with the changes in benefits and risks that can go with them.

They are not identical services, and I think the best way to think about that is at the time, given that they were developed under similar circumstances, we can look at them then and what we see in the interim is just information about how the risk characteristics of the services might unfold. We don't have proof because we haven't really said anything, but we certainly have evidence, for instance, MRO prices which change around depending on when they occur. The ESP prices would do that to nearly the same extent.

Is that a good thing or not? That's the Commission's test to assess.

Q. Are you finished?

A. Yes.

MR. BELL: Thank you, Mr. Graves, I have no further questions.

EXAMINER PRICE: Mr. Dunn?

MR. DUNN: No questions, your Honor.

EXAMINER PRICE: Hospital.

MR. SITES: No questions, your Honor.

EXAMINER PRICE: Ms. Wung?

MS. WUNG: No questions, your Honor.

EXAMINER PRICE: Mr. McNamee.

MR. McNAMEE: Oh, thank you.

- - -

CROSS-EXAMINATION

By Mr. McNamee:

Q. Goods afternoon, Mr. Graves.

A. Hi.

Q. Let me see, your predecessor on the stand, Dr. Jones, used a calculation of yours in his Exhibit 7.
Do you happen to have his testimony in front of you?

A. I don't.

Q. You don't.

EXAMINER PRICE: Maybe can you supply the witness with a copy of Dr. Jones' testimony?

MR. McNAMEE: He can have mine.

A. I'm sorry, what exhibit did you say?

Q. 6 and 7 actually.

A. Okay.

Q. Do you have column denominated Reserve Margin -- or there is a column denominated "Reserve Margin."

A. Yes, I see that.

Q. And that's credited to you, I believe.

A. Well, the calculation is his, but it's derived from data that I compiled in past proceedings.

Q. Okay. What data is that? How did -- how --

A. It's described right there and it's visible right there's the average, his observed margin is the average of the margins in column just to the left of that which in turn were taken from a hearing in Maryland on the question of what kinds of risk premiums tended to prevail in full requirements outsourcing and whether or not those risk premiums could be eliminated through a managed portfolio procurement.

Q. How were those observed margins determined?

A. To some extent in a fashion that's analogous to the constructed cost methods that Dr. Jones and I both did here.

I took data from about 50 public procurements full requirements service that had occurred since 2003, I believe that is the first one, first PGS auctions in New Jersey, and reconstructed what I thought would be the cost of service to convert wholesale prices, then prevailing for energy capacities ancillary services congestion and so forth into an expected cost for the retail service in those territories at that time, and I compared that cost to the auction prices that prevailed, and the difference was a margin largely distributed to risk but also to other factors.

Q. Okay. This observed margin as you calculated it would include all of the other sorts of risks that you discuss elsewhere in your -- in your testimony this season. Your testimony that we are looking at right now would be a summation, if you will?

A. Sure, I guess that's fair enough to say. They describe everything else that the parties who won those auctions felt was necessary to justify participation in those services would have and beyond the components that I had estimated.

Now, there is at least two or three reasons why that margin might be present. One is I might have estimated the numbers that they would use in their analysis incorrectly, so I may have relied upon estimates that they didn't share, so there could be an estimation factor in it.

Another is risk premium, they demand a

risk premium for the switching risks and all the utility risks and credit risks and so on.

And then the third is it's plausible, but I don't think likely, that the auctions themselves allowed the parties to obtain a premium of some kind to give to the extent they weren't competitive auctions.

Now, I should say none of them were found to have that problem that -- not at least in the data I relied upon, so I don't think that's present, but the margin is the result of the character of the auction, my estimation technique and risk premiums that the parties to the auction wanted to earn.

Q. Okay. So I'm trying to determine what was actually observed. The only thing that was observed was the bid price, right?

A. Sure, and we don't know that the parties who won would call it a risk premium or they might call it a profit margin. We don't know.

Q. Okay. So the balance -- what you have is an observed price with your calculation of what that observed price breaks down into, right?

A. I have an observed price in the auction and then we have my calculations what some of the notable elements of cost would be and the residual that I couldn't explain with known elements is the margin.

Q. Okay. All right. And you use the same methodology that you did in your testimony to derive, I guess, this what's been denominated as a reserve margin, the methodology is the same.

A. Well, here both of us used -- ran that process in reverse we built up a structural model of what the known elements were to create an MRO service and then added on a risk premium of the same magnitude that's been observed in other auctions where people were providing that kind of service.

Q. Okay. All right. Speaking of auctions, Mr. Graves, you are aware, are you not -- let's -- let me preface this.

Long ago you were asked about the 2004 FirstEnergy auction.

A. I remember.

Q. Okay? You are aware, aren't you, that although that auction was in 2004, the actual contract period that would have been served by the -- that auction was 2006, 2007, and 2008, which overlaps at least in part with the procurements that you used in your analysis.

A. Yes, a little bit. It does overlap, but it starts -- but it was transpired long before then. The period the MISO hadn't yet been put into operation, Hurricane Katrina, it was a very different environment.

As we point out, it was for service that began in a year later and that by itself creates a difference between what I was trying to estimate and what occurred then.

Q. Although you just testified I think that the procurements that auctioned went back to 2003; isn't that right?

A. Yes, for purposes of estimating a risk premium, so I do use those in Exhibit 7 going all the way back to 2003, but I don't use those in my comparable analysis, those are all much more contemporaneous and I only use auctions that had service beginning in 2007 or later. So it would have been Exhibit 2, there is no 2003 auctions in that.

Q. Why would you reach to a different period, to different risk? Why would you reach -- in fact, why would you reach farther back to measure a risk premium?

A. Well, I think the risk premium, though sensitive to other factors, like forward prices and capacity rules and so on, is in some ways less sensitive to those than all the other factors that I'm updating my comparables and construction cost analysis, because what's to the extent -- especially to the extent risk is rising from customer switching, the big concern is what's the likelihood that prices will change after the auction price is set to some level that makes customers wants to leave.

That question remains interesting going back to 2003, even though it admittedly is slightly different circumstances in a way than asking about the character forward price's asking price in 2003 doesn't.

Q. Okay. Again, long ago in your cross-examination you indicated that you used RPM capacity prices in one of your calculations.

A. Correct.

Q. Those, of course, would not apply to bidders for FirstEnergy load in Ohio, correct?

A. That's right.

Q. Okay. And those RPM capacity prices would be significantly higher than the capacity prices used by Dr. Jones that he got from the company?

A. Yes, and they are also higher than the ones I used for the FirstEnergy assessments.

Q. Okay.

A. I don't apply RPM prices to Ohio. I apply the same capacity prices that Dr. Jones used.

Q. Okay. Let's talk about Maryland and New Jersey a little bit. You deal with some -- or you considered some procurements there.

Would you agree with me there are differences in the electricity matters in Maryland and New Jersey versus Ohio?

A. Sure, and there are some similiarities.

Q. Okay. Would you agree there is more congestion in New Jersey and in Maryland than there is FirstEnergy?

A. Yes, that's my understanding, and I take that into account in my analysis.

MR. McNAMEE: Okay. That's all we need. Thanks so much.

EXAMINER PRICE: Mr. Hayden?

MR. HAYDEN: Your Honor, if we could have a minute, please?

EXAMINER PRICE: Certainly.

MR. HAYDEN: Can we take a break, 5, 10 minutes?

EXAMINER PRICE: Yeah, why don't we take our 15-minute break here. We will return at 3:50 and then if you don't have any questions or very brief, and then go on to Mr. Schneider.

(Recess taken.)

EXAMINER PRICE: Let's go back on the record.

Mr. Hayden.

MR. HAYDEN: Yes, your Honor just a couple of questions.

- - -

REDIRECT EXAMINATION

By Mr. Hayden:

Q. Mr. Graves, in your examination there was some questions about whether or not you were testifying on what the price would or should be in ESP.

Do you remember that?

A. Yes.

Q. Can you clarify your answer on that point, please?

A. Yes. Just to make sure it's clear, I'm -- my testimony should not be construed as an attempt to say what a fair price for the ESP services are.

My testimony is about the price of an MRO full-requirements fixed price service as of the middle of the summer, and that is an input to the Commission's consideration of whether they prefer service under those terms and prices as they would appear to have been available in July to the ESP as it was designed in July.

Q. Thank you.

And you were also asked some questions about riders in the ESP and their affect on prices over time.

Do you recall those questions?

A. Generally, yes.

Q. And is there any analogous effect in the MRO?

A. We've talk about MRO, it results in a once and for all fixed price, because at the time each MRO auction occurs, the bidders offer a fixed price but, in fact, if MRO process is adopted, there will be a series of installments of procurements beginning with 100 percent of the first 17 months being procured at the end of this year, and then two-thirds being procured for 29 months and one-third for 41 months, with subsequent auctions layered in two per year in the future to fill in their future requirements at a time.

And as a result, the price that customers would see from all those iterative MROs would be a price that ebbed and flowed over a fairly long cycle with the -- with the changes in the market and it would tend to move up or down somewhat akin to the fashion the riders will cause the ESP price to change.

MR. HAYDEN: Thank you. I have no further questions, your Honor.

EXAMINER PRICE: Mr. Small?

MR. SMALL: No questions, your Honor.

EXAMINER PRICE: Mr. White.

MR. WHITE: No questions.

EXAMINER PRICE: Ms. Wung.

MS. WUNG: No questions.

EXAMINER PRICE: Ms. McAlister.

MS. McALISTER: No questions.

EXAMINER PRICE: Ms. Fonner.

MS. FONNER: No questions.

EXAMINER PRICE: Mr. Smith.

MR. SMITH: No questions.

MR. BREITSCHWERDT: No questions.

EXAMINER PRICE: Mr. Stinson.

MR. STINSON: No questions, your Honor.

EXAMINER PRICE: Mr. Lavanga.

MR. LAVANGA: No questions, your Honor.

EXAMINER PRICE: Mr. Boehm.

MR. BOEHM: No questions, your Honor.

EXAMINER PRICE: Mr. Bell?

MR. BELL: Surprisingly, no.

EXAMINER PRICE: Mr. Dunn.

MR. DUNN: No questions, your Honor.

EXAMINER PRICE: Staff?

MR. McNAMEE: No questions.

EXAMINER PRICE: Thank you, you're excused.

MR. HAYDEN: Your Honor, I move for the admission of Company Exhibit 7, direct testimony of Frank Graves.

EXAMINER PRICE: Any objections to the admission of Company Exhibit 7?
Hearing none, it will be admitted.

(EXHIBITS ADMITTED INTO EVIDENCE.)

MR. HAYDEN: Also move for the admission of Company Exhibit 7A, which is a correction to Mr. Graves' testimony response to OCC Set 3 RPD-29.

EXAMINER PRICE: Any objections to the admissions?

MR. SMALL: Yes, your Honor.

EXAMINER PRICE: Mr. Small.

MR. SMALL: Yes. I have no objections to

the table, which is page 3 of this exhibit, and I have no objections to part B on the first page, which is essentially his explanation for why he is offering the exhibit.

And I have no objections to the last sentence on the first page and continuing over to the second page, which is again an explanation for why this substituted table has been presented.

I do object to the admission of anything else on the page. It was not presented through the witness. It was not verified, and in response to my questions, it was clear that the response here was incomplete.

And there is other material which other parties would have the right to inspect and admit other portions of it if -- if these parts were admitted, so the OCC objects to the other parts of it that I have not described.

EXAMINER PRICE: Mr. Hayden.

MR. HAYDEN: Your Honor, we are really trying to move in a correction to his testimony and I didn't hear the letters that Mr. Small said, but I believe those corrections are encompassed in the response part B and D, or the last section there of and the table which was included in the pack that I'm handing out.

I am not trying to move in for admission the remainder, which I think is in response to what Mr. Small is talking about here.

EXAMINER PRICE: So the parts that everybody is in agreement is part B; is that correct, Mr. Small?

MR. SMALL: You said B?

EXAMINER PRICE: B.

MR. HAYDEN: B.

MR. SMALL: Yes, we are in agreement.

EXAMINER PRICE: Okay. And part D? Mr. Hayden, did you say D?

MR. HAYDEN: I said D, yes.

MR. SMALL: And I was saying the last sentence of D.

EXAMINER PRICE: The last sentence of D.

MR. SMALL: Starting "Mr. Graves is submitting," and continuing on to the second page.

EXAMINER PRICE: Is that acceptable, Mr. Hayden?

MR. HAYDEN: Are you saying the last three sentences which spill over onto the next page?

EXAMINER PRICE: I believe he is. Is that correct?

MR. SMALL: That's correct.

MR. HAYDEN: Your Honor, these sentences just clarify that this is -- this is a correction to his testimony.

EXAMINER PRICE: He's not objecting to those sentences. That's the part that's unobjectionable. He is objecting to the first two sections.

MR. HAYDEN: Then we are in agreement.

EXAMINER PRICE: Okay. Just to clarify then, Company Exhibit 7A will be moved in to the extent and only to the extent that includes Section B and the last paragraph of Section D and the table. That exhibit will be admitted.

(EXHIBITS ADMITTED INTO EVIDENCE.)

MR. McNAMEE: Your Honor.

EXAMINER PRICE: Ms. NcNamee?

MR. McNAMEE: Your Honor, during the break I handed out, hopefully to everybody in the room, updated schedules of our accounting witness, Mr. Tufts. Those are docketed today.

In addition to giving them out to I hope everybody -- did everybody get one? Missed one -- they have been served electronically on everyone.

EXAMINER PRICE: Thank you.

Ms. Miller, are you next?

MS. MILLER: I am, thank you, your Honor. The companies call Donald R. Schneider.

(Witness sworn.)

EXAMINER PRICE: Please be seated and state your name and business address for the record.

THE WITNESS: Donald R. Schneider, senior vice president of Energy Delivery, and senior vice president of the utilities.

EXAMINER PRICE: Ms. Miller, please proceed.

MS. MILLER: Your Honor, the companies would like to premark the direct testimony of Mr. Schneider as Company Exhibit 3.

EXAMINER PRICE: So marked.

(EXHIBIT MARKED FOR IDENTIFICATION.)

\- - -

DONALD R. SCHNEIDER

being first duly sworn, as prescribed by law, was examined and testified as follows:

DIRECT EXAMINATION

By Ms. Miller:

Q. Good afternoon, Mr. Schneider. How are you today?

A. I'm good.

Q. Do you have before you what has been

premarked for identification as Company Exhibit 3?

A. I do.

Q. Is Company Exhibit 3 your direct testimony in this proceeding?

A. Yes.

Q. Do you also have before you what was previously marked in this proceeding as Company Exhibit 10?

A. I do.

Q. And Company Exhibit 10 is the company's errata; is that correct?

A. That's correct.

Q. Do you sponsor the items on Companies' Exhibit 10 that bears your name?

A. I do.

Q. And if you were asked the same questions in your testimony subject to the changes made on the errata, would your answers be the same?

A. Yes.

MS. MILLER: The witness is ready for cross.

EXAMINER PRICE: Thank you. Mr. Small -- Mr. Reese, I'm sorry.

MR. REESE: I'm shorter.

- - -

CROSS-EXAMINATION

By Mr. Reese:

Q. Good afternoon, Mr. Schneider.

A. Good afternoon.

Q. I believe we've talked before. I wanted to call your attention to Page 2 of your testimony, line 17.

As I understand it, you are sponsoring paragraphs A3E, A3F, A3G, and A4F of the companies' Application; is that correct?

A. That's correct.

Q. Or the plan.

A. That's correct.

Q. Thank you.

MR. REESE: May I approach?

EXAMINER PRICE: You may.

MR. REESE: Thank you.

MR. WHITE: Excuse me, Rick, is that going to be marked as an exhibit?

MR. REESE: No, it isn't.

Q. Mr. Schneider, what I have provided you is the portion of the Application. If you flip back several pages, you'll come to the paragraphs that we were just discussing. I believe it would be page 21.

A. I'm on page 21.

Q. Okay. At the top of 21 of the Application or paragraph, this is A3E, I want to talk to you about this paragraph first.

It's my understanding based on this paragraph that you're -- that the FirstEnergy companies are proposing a delivery service improvement rider; is that correct?

A. That's correct.

Q. And this rider would be in place for the period January 1, 2009, through December 31, 2011; is that correct?

A. That's correct.

Q. Now, this is not numbered as your testimony is, but approximately six lines down we have a sentence that begins with "The DSI rider will help enable the companies to manage the increasing costs providing electric distribution service."
Do you see that?

A. Are you still in paragraph E?

Q. Yes, I'm.

A. Yes, I see that.

Q. "We have the need to expend capital for equipment far earlier than before."
Can you explain why there is a need to expend capital for equipment far earlier than before?

A. Yes. That's referencing the extended lead times that we are experiencing with our suppliers of large transformers.

Q. Are there any other examples?

A. We have a similar situation with new large vehicles. We recently experienced the financial organization that was leasing some of those vehicles for us, quit leasing them, and so now we have to place orders directly through capital expenses.

Q. Continuing with that sentence "the need to train new employees to replace retirees." What is new about the current time frame regarding training new employees?

A. Could you repeat that question?

(Record read.)

A. We are referring to the magnitude of new employees that we need to hire and bring into the organization to replace retiring employees.

Q. Now, there is an expanded need, if you will, to train new employees. Has FirstEnergy -- the FirstEnergy companies in Ohio neglected to keep up with hiring?

A. No, not at all. Where we find ourselves today is that at about 50 percent of our work force in the Ohio companies will be retirement eligible in the next three to five years.

And we've established what I think to be one of the best programs in the industry. We refer to it as our PSI program, Power Systems Institute, and we've had that program up and running in the state for about -- about seven -- seven or eight years.

Now, we have had to ramp up over that seven or eight-year period, but now we now have six schools around the state of Ohio and the recruiting that we do is primarily out of high schools, and we will bring in individuals that graduate from high school into our PSI program. They will spend two years in this program.

It is some physical work, it's also technical work, mathematics, electrical circuit theory, that sort of thing.

They will also spend a portion, primarily the summertime they come to work for us on a full-time basis, and once they then graduate from the PSI program after that two years in school, then we bring them into a training program as a full-time employee.

And then over about the next five years

they can ramp up and become, you know, a full -- what I would call a full-fledged lineman.

So we haven't neglected at all, but we are at a point now where we are bringing in in 2009 I think we will bring in about 200 or 220 new employees into -- into our organization, so this would be 220 that would have graduated from PSI. They would have started in 2007, graduate in 2009, and start that five years training program in-house.

Q. So these 220-odd employees that are just coming out of training, how many employees are they replacing?

A. I don't know exactly that number in the -- you know, in the time frame that those employees will be coming in.

Our hope is actually that we have an overlap because, again, these employees, although they are very well trained in the classroom and some physical work, they are not in a position where we could let them out kind of by themselves. In other words, they are not full-fledged lineman.

So what we really need to go through, one of the things creates the challenge for us, we need to put these new employees with the trained veterans to allow that five-year transition of knowledge.

So our hope is actually that the way we time this is that the new employees will have about five years worth of veterans and, again, that's about the time frame we see 50 percent of our employees being eligible for retirement, so we will have a smooth transition there.

Q. Was FirstEnergy doing this five years ago?

A. To a much lower magnitude, five years ago. But, yes.

Q. Can you give me an idea of the magnitude?

A. I can't go back five years, but I can tell you that in 2007 we graduated about a third of that number, about 70 employees versus the 210 so, and, again, you have got to remember that when I talk about an individual graduating, so then you have to back up from there five -- two years, because if they graduated in '07, that means they started the program in 2005.

So in '07 we graduated about 70 in Ohio, and if you go back about seven or ten -- seven or eight years when we first started the program, I think we started with two schools so we had about 40 individuals enrolled in the school, and so that kind of breaks it out for you.

Q. I'm still trying to understand, there's something unique about the current time frame that requires the company to offer this DSI rider. Is it all right if we refer to it as the DSI rider?

A. Yes, that's fine.

Q. You've offered this rider in part to train new employees. I'm still not clear on why that rider is necessary now for the company to train employees as opposed to two years ago, three years ago, five years ago, ten years ago. What's unique about 2009?

A. It's really the magnitude. Again, as I tried to explain, if you go back in time, we started with our first school probably about eight years ago. We had about 40 -- about 30 students enrolled in that first school. Today as you look into 2009, we are now up to about 220 students.

We pay the tuition for those students in the school. That's an expense, and then we also will be graduating about 210 from the schools and we will be putting them on our payroll, especially increasing our staffing level beyond what you would see today.

Q. Do you have an idea of how many employees are dedicated to distribution service reliability within the FirstEnergy Ohio operating companies now as compared to 2005?

A. Well, I can partially answer that question.

I believe right now that our Ohio companies have about 2,500 employees. They are all dedicated to providing reliable service to our customers.

Going back to 2005, I don't know the exact number that we had back in 2005.

Q. The 2,500 number is for all of your employees in Ohio; is that correct?

A. That's correct. That's what I was referring to.

Q. The DSI rider is not to help pay those 2,500, isn't it a subset of those 2,500?

A. The DSI rider -- could you rephrase that? I am not sure I understand the question.

Q. Well, back to the paragraphs A through E, the sentence we are still on, "The rider will help enable the companies to manage increasing costs. One of those increasing costs is the need to train new employees and to replace retirees."

Now, you've mentioned there's 2,500 employees of the FirstEnergy operating companies in Ohio; is that correct?

A. That's correct.

Q. Now, when you are talking about training and replacing employees, are you talking about training and replacing those 2,500 or some subset of that 2,500 that are dedicated to providing distribution system reliability?

A. Now, I understand your question. Really what I was trying to explain what our challenge is, we are going to be bringing on 200 new employees in 2009.

And we actually hope that we don't lose any of our experienced employees in 2009 because we need to provide this transition.

That 200 or 210 will keep recurring every year, so what was 200, an additional 200 employees in 2009 will be 400 in 2010 and 600 in 2011, 800 in 2012.

And then what you hope to do is as you build that up and you look to where -- to our existing demographics, you hope there is about a five-year transition where we actually would be, if you just look purely at the numbers, you would say you are overstaffed because you are a lower number three years ago and you are a higher number now.

But the reason you become overstaffed

and, of course, that comes at a cost, is because an individual coming straight out of PSI, even as good as it is, they are not a fully competent lineman. You can't put them by themselves like you would a fully competent lineman. So it's the overstaffing that we are referring to here.

Q. So it's not possible that FE is understaffed right now?

A. I don't believe we are understaffed right now.

Q. Do you have the same number of lineman that you had five years ago?

A. I don't know the answer to that.

Q. Let's continue on with the sentence, the need to replace -- excuse me, components of an aging distribution system, the distribution system -- and -- isn't the distribution system comprised of various components, such as poles, conductors, arrestors, substations, animal guards?

When you say "an aging distribution system," I don't understand that. You are not going to build an entire system, are you?

A. I'm sorry, there was a lot there. Could you maybe just break that down just a little bit and just ask one question at a time?

Q. The distribution system is comprised of many components; is that correct?

A. That's correct.

Q. It's composed of -- comprised of poles, comprised of transformers, animal guards, cutouts, substations; is that correct?

A. Those would all be examples of our distribution system.

Q. Well, in particular when you mention an aging distribution system, which components of the distribution system are you referring to in specific?

A. Many of those components that you mentioned, to give you an example in CEI alone, we have over 300 of our distribution transformers that are over 50 years old.

In fact, we have two that are over 100 years old, and they are still operating fine today, but they are -- they are very old.

Q. And why haven't they been replaced?

A. Because they are still meeting the needs of the customer.

Q. And if the DSI is approved, you will replace those transformers?

A. Well, I wouldn't say we would replace those specific transformers, the ones that I just mentioned, but the point of the DSI improvement -- DSI rider is that when we look at our system and our infrastructure in all three of our operating companies, we are not different than other utilities around the country.

We all -- we all are struggling with the same issue, and that is an aging infrastructure. Much of our infrastructure was built to support the Baby Boomers as they bought homes and built homes. For example, in Cleveland in CEI the average age of the home is 48 years old. Well, that's when a lot of our stuff was put in the ground was, you know, 48 years ago to support that large build out, and now we find ourselves with a large majority of our infrastructure being well past what -- what was originally anticipated when those systems were put in place.

Q. Well, haven't ratepayers being paying all along for updates and upgrades of the distribution system so that they receive reliable service?

A. Could you repeat the question?

MR. REESE: Can you read it back for him, please.

(Record read.)

A. Yes, I think the customers have been

providing the utilities revenue and I think we have been providing excellent reliability.

But what I'm talking about today is as we look to the future and we look at the age of this infrastructure, I believe things are -- things need -- they are different today than they have been in the past three or five years.

Q. Now, I may be a bit premature, we may come back to this again when we go over your testimony, but you talk -- you mentioned a little bit ago about these transformers, some of which were 50 to 100 years old.

Would any of those -- would those transformers be maintained or replaced absent approval of the DSI?

A. That's two different questions. Could you ask that one at a time?

Q. I two questions but I'll ask it again. A little while ago you mentioned some old transformers. I believe you said they were 50 -- some were 50 to 100 years old; is that correct?

A. That's correct.

Q. You gave that as an example of the aging distribution system; is that correct?

A. That's correct.

Q. Now, if the DSI rider is not approved, will those transformers be maintained properly and/or replaced as needed?

A. Yeah. That's what had me crossed up is the first time you asked the question I think you said "maintained or replaced." "And/or" is a little easier for me to address.

Obviously we will continue to maintain the transformers. Our ability to replace the transformers would, of course, be limited because the DSI rider will provide us a revenue that will allow us to be more proactive towards replacing some of our aging infrastructure.

Q. Now, I see from the paragraph E, last three lines, that the proposed DSI rider is two-tenths of a cent per kilowatt hour; is that correct?

A. Are you referring to the last line where it says 0.2 cents?

Q. That's right.

A. Yes, that's correct.

Q. And how did you arrive at the two-tenths of a cent?

A. We looked at all the things that we believed we needed to do to continue to ensure the reliability of our system for our customers. We looked at the aging infrastructure, we looked at the need to replace the retiring employees, we looked at the $2 billion -- or I'm sorry, the $1 billion commitment that is included in here.

And when you put all those things together, we came up with a dollar value that is representative of this 0.2 cents.

Q. Now, did I read in your testimony -- we can cover this again in a little bit, but did I read in your testimony that the DSI is not cost based? I'm just asking if you know.

A. The DSI is not cost based, that's correct.

Q. Okay. Let's move on to paragraph F on page 21 of the Application. The first sentence, "In order to align customers' and the companies' interests."

How do you align customers' interests with the companies'?

A. I think if you read the rest of that sentence, it talks about the rider is going to be subject to an upward or downward adjustment based on a reliability performance.

Q. There is a discussion here of this upward or downward adjustment each annual period. That adjustment will take place for each of the Ohio operating companies; is that correct?

A. That's correct. There's a -- the very last sentence in the paragraph that talks about that, the annual adjustment shall not exceed the 15 percent.

Q. While we are on the 15 percent, can you tell me why 15 percent? Why is that cap 15 percent?

A. It was management's discretion. That's what we have put in the proposal.

Q. So in a given year and, again, we will be getting into this in more detail because we are talking about SAIDI as the measurement that you are basing this on the performance band for SAIDI, if one of the three operating companies, let's say, Ohio Edison, I believe the target that you've proposed for each of the companies is -- well, the existing targets for Ohio Edison and Toledo Edison are 120 minutes per year; is that correct? For SAIDI?

A. That's correct.

Q. And you are proposing a new target for CEI of 120 minutes; is that correct?

A. For SAIDI, that's correct.

Q. That's correct. And that's an increase of about 25 minutes from what the current CEI SAIDI target is?

A. That's correct.

Q. Okay. And the performance band would extend as proposed by the FirstEnergy companies, the performance band would range from a low of 90, which is actually good, to a high of 135; is that correct?

A. Yes. What we have proposed is that if we would perform better than 90 minutes of SAIDI, there would be an incentive based on the table that's attached to the Application.
Above 135 minutes there would essentially be a penalty, and when you look at that -- at those values, 90 minutes is really extremely good.

It's very near top decile when you look at the EI statistics 135 minutes is actually still just slightly outside the top quartile, so it would represent performance that would be better than probably 65 percent of the -- of the companies in the United States.

EXAMINER PRICE: Mr. Reese, one second please.
You have titled your rider Delivery Service Approval; is that correct?

THE WITNESS: That's correct.

EXAMINER PRICE: I am not sure whose service is approved if the Ohio Edison customer, and you are reading your SAIDI target of 120 minutes and you have a new SAIDI target of 120 minutes, that's not an improvement, is it?

THE WITNESS: Just because you change the target doesn't --

EXAMINER PRICE: But that is the target, if you hit your target last year and you hit the new target, that will not be an improvement, will it?

THE WITNESS: So for Ohio Edison the target is 120 last year?

EXAMINER PRICE: Huh-uh, existing target is 120; is that correct?

THE WITNESS: Yes, that's correct.

EXAMINER PRICE: And the new target will be 120.

THE WITNESS: That's correct.

EXAMINER PRICE: If you hit the target last year and you hit the new target, that's not an improvement, is it?

THE WITNESS: No, but Ohio Edison did better than their target last year.

EXAMINER PRICE: I understand, I am talking about the targets now, I'm just talking about the targets.

My point is you haven't improved the targets. You are calling this a delivery service improvement rider, but out of the three operating companies, two are not changing their targets and one is increasing their target, is that not correct?

THE WITNESS: That's correct. However, I think when you look at the bands that we are establishing, we will be striving to do better than what the target is.

In fact, Toledo Edison has historically performed much better than their target, and Ohio Edison finished better than the target, so we want to continue to improve and continue to maintain in some cases.

EXAMINER PRICE: So why would you not make the targets more stringent for Ohio Edison and Toledo Edison?

THE WITNESS: Because we believe 120 minutes represents and optimal point. We are balancing cost of reliability versus the reliability for the customers.

EXAMINER PRICE: Thank you.

Q. (By Mr. Reese) Now, those that know me, Mr. Schneider, know I don't live on the sunny side of the street, so let's talk about the instance in which your SAIDI performance, let's, again, back to Ohio Edison for a given year is extraordinarily high or poor, let's say it's 175 minutes instead of the outer bands of 135, and again, even above the target of 120. Why should there be a 15 percent cap on an adjustment to the DSI?

A. I'm sorry, you said a lot. You kind of lost me when you talked about the sunny side of the street, to be honest about it.
Could you just maybe ask it one question at a time?

Q. Okay. If the companies -- if Ohio Edison's SAIDI is extraordinarily bad in a given year, let's use 2009, and instead of the target of 120 and instead of the outer bands of 135 it comes in at 175.

Why should the DSI adjustment be limited or capped at 15 percent?

A. I think I understand what you are asking. You are asking me if -- if this is all approved, that it's in place starting in 2009 and so, therefore, the targets are established and the bands are established and Ohio Edison performs at a level of SAIDI that would be above the 135, you are asking me why would you cap that at 15 percent?

Q. No. That was a three-part question. Can you repeat it? Sorry, that's a joke. Yes.

A. When we established 15 percent, we believed that that created an incentive opportunity on the low side and a penalty on the high side that would incent our companies to -- to go the extra mile, if you will, to provide better reliability for our customers.

Q. So the rider will be providing the company additional revenue; is that correct?

A. That's correct.

Q. And if, back to my hypothetical with Ohio Edison, if it has a particularly bad year and the SAIDI measure comes in at 175, which we would all agree is pretty bad.

A. I can't agree to that.

Q. You won't agree with that?

A. No.

Q. So if the outer band of performance at which a -- an adjustment would be made to the DSI is something well beyond that outer performance band, you wouldn't consider that poor?

A. I can't -- I can't use the word "poor" because I don't know all of the situations that way driven that level of performance in that given year.

Q. But you did characterize 89 as good.

A. I characterized 89 as good compared to EEI standards as you look at what other companies have done.

I think even at 170 I think that, again, although I would need to know all the specifics about what occurred, that would be better than at least one other utility in the state's target.

Q. We can deal with them later, but right now we are talking about your company and about your historical performance.

You've proposed a performance band and yet you are saying if the company performs outside that performance band, it's not necessarily an indicator that they are performing poorly; is that what you are saying?

A. That's correct. As a matter of fact, again, the 135 would put any one of my companies in a position that they would be better than about 65 percent of the companies across the country. That would still be very good performance.

Q. But you still maintain that 89 would be good.

A. Eighty-nine would be outstanding. That would be excellent.

Q. Okay, okay. Let's go stick with the cap question for a minute though.

Why is there an upper or lower limit? Why 15 percent?

A. Again, that was -- that was management's discretion what we put in the plan. We think that it's significant enough to incent our employees at our operating companies to -- to go the extra mile, to provide the reliability to our customers, you know, the best reliability they possibly can.

Q. Haven't you proposed that the rider itself is an incentive?

A. No. The rider itself is not adjusted based on performance.

Q. The rider is not ajusted on performance? The rider .2, it isn't to a 15 percent adjustment up or down; isn't that correct?

A. Well, the base rider starts out at .2 times the kilowatt hours. That's the portion that I'm saying is not adjustable based on performance.

The 15 percent is either on top of that or below that, so if you think about the DSI rider just for -- just to make the example, I think that that probably comes out to about $115 million a year, and so $115 million would be subject to a 15 percent increase or 15 percent decrease based on performance.

Q. Within this 15 percent, this zone above or below the performance band, there's certain incents, and I don't have it with me, but just -- I think it was in your tariff pages. If you are not comfortable answering this, let me know.

But there are -- there can be incremental -- there can be an incremental downgrade of performance or -- strike that. Let me start over.

There can be an adjustment of less than 15 percent up or down; is that correct?

A. Are you referring back to the performance band?

Q. Correct?

A. The annual?

Q. Correct?

A. Yes, it could be less than 15 percent.

Q. Now, there is -- how were -- how are the incremental adjustments to the rider calculated? In other words, if, going back to Ohio Edison, if they perform at 137, which is 2 minutes outside the performance band, that would -- that would result in some adjustment; is that correct?

A. That's correct.

Q. And how is that incremental adjustment calculated?

A. There's a -- I don't have it with me, but there was a table that was provided with the Application that would lay out that math.

Q. Can you give me -- do you have any idea what the rationale was for those increments? How they were arrived at?

A. No, I don't.

Q. Do you know who would?

A. I believe Greg Hussing was responsible for laying out the implementation.

Q. Does Mr. Hussing have anything about the rider in his testimony?

A. I can't be sure.

Q. Do all customers -- well, I'm sorry, rephrase, I would like to rephrase.

Will all customers experience this two-tenths of a cent per kilowatt adjustment or will it be -- I'm sorry, DSI? Will all customers see that or some customers' DSI be higher or lower?

A. DSI charge applies to our distribution customers.

Q. So will all distribution customers experience a two-tenths of a cent per kilowatt DSI or will it be different for different classes of customers?

MS. MILLER: Objection, your Honor. That goes more into the implementation of the DSI rider and not the purpose of the DSI rider.

EXAMINER PRICE: Okay. But I don't understand the grounds for your objection.

MS. MILLER: This witness' testimony is not pertaining to the implementation of the DSI rider as he had indicated, that's Mr. Hussing.

EXAMINER PRICE: Mr. Reese.

MR. REESE: Your Honor, Mr. Schneider is sponsoring these paragraphs of the Application. And this is where the two-tenths per kilowatt is set forth and it's not sponsored by any other witness that I am aware of.

EXAMINER PRICE: He can answer it if he knows.

THE WITNESS: I don't know.

Q. (By Mr. Reese) Now, talking about the range of -- the performance range in paragraph F, and there's reference to -- about halfway down paragraph F, on page 21, there's a discussion which I believe you go into in a little more depth in your testimony, but it talks about this revised target for CEI.

Do you see that?

A. Yes, I do.

Q. Now, the current target for SAIDI, as I understand it, for CEI is 95 minutes; is that correct?

A. That's correct.

Q. And the companies' proposal as part of the DSI is to increase CEI's target from 95 to 120 minutes; is that correct?

A. That's correct.

Q. I don't have my calculator with me but I had it with me yesterday and I think that's about a 26 percent increase in the SAIDI target for CEI; does that sound right to you, subject to check?

A. Subject to check, that sounds about right.

Q. And in addition to the adjustment of CEI's SAIDI targets, the company is recommending that there be a rear lot adjustment factor, or I'm sorry, a real lot reduction factor applied to CEI circuits where 50 percent or more of the customers are served by rear lot facilities; is that correct?

A. Could you read that back, please.

(Record read.)

A. That's correct.

Q. Can you tell me what the -- I believe there's been some back and forth on exactly how many circuits are impacted by the rear lot reduction factor. Do you know where that number stands right now?

A. I believe the numer is 439 circuits.

Q. So approximately 439 of CEI's circuits would be subject to the rear lot reduction factor; is that correct?

A. That's correct.

Q. And that reduction factor operates -- that reduction factor, I believe, is a .5; is that correct?

A. That's correct.

Q. So even though CEI's SAIDI target is recommended to be changed to 120 minutes, and its performance band would be -- then be identical to the other two operating companies would be 90 to 135, in fact, the band would be wider than that, wouldn't it?

A. That's not correct. We've proposed a band for CEI the same as Ohio Edison and Toledo Edison.

Q. So the band would remain the same?

A. And the target, that's correct.

EXAMINER PRICE: So what does the rear

lot reduction factor modify?

THE WITNESS: What the rear lot reduction factor is intended to do, if you look at the three companies, CEI, as we just discussed, has about -- about 50 percent of their circuits that's just slightly less than 50 percent as 439 where 50 percent or more of the customers are served from rear lot.

If you compare that to Ohio Edison and Toledo Edison, those two companies have less than 10 percent of their circuits and so you have a structural difference between CEI and the other two companies with all these rear lot facilities.

And the rear lot facilities are much more difficult to repair timewise, just takes longer for our employees to get into the back. They can't back their trucks into the backyards. They have got all kinds of obstacles back there, like dogs and swimming pools and that kind of thing.

And so what we have attempted to do with the rear lot reduction factor is adjust CEI's minutes to -- to compensate for that structural difference, and that would then put all three of those companies on a level playing field.

EXAMINER PRICE: But in essence then for 50 percent of your circuits their SAIDI target would be 240 rather than 120 because it would cut their outage minutes in half, that would be the net affect, would it not?

THE WITNESS: I don't think so.

EXAMINER PRICE: Fair enough.

You say in your testimony that that rear lot reduction factor is necessary to do an apples-to-apples comparison of the three companies; is that correct?

THE WITNESS: That's correct.

EXAMINER PRICE: But on the other hand, on page 9 of your testimony you say that IEEE examines the reliability performance and has already done the apples-to-apples comparison.

So I don't understand if the existing system with the 2.5 Beta method creates an apples-to-apples comparison, why we need to do a further adjustment to do an apples-to-apples comparison.

THE WITNESS: It is true on page 9 when I talk about the IEEE 2-1/2 Beta method, by design when you do a 2-1/2 Beta method, you don't look at any kinds of exclusions, you don't look at storm exclusions, you don't look at rear lot reduction factors.

You look at the raw numbers and then you apply statistical analysis for the raw numbers and, therefore, you can look at utilities across any -- any operating company.

It doesn't necessarily even have to be Ohio, so that level sets all operating companies one against the other.

The rear lot reduction factor that we are -- we are proposing is for our SAIDI -- our DSI rider adjustment, so it's two different things.

EXAMINER PRICE: Fair enough. Mr. Reese.

Q. (By Mr. Reese) Okay. Let's look at footnote 16 at the bottom of 21, under paragraph F there.

"For techical reasons, the DSI rider is actually effective through 2013. But the charge in 2012 to 2013 is zero cents per kilowatt hour."

Can you explain that to me?

A. Yes. What we are trying to lay out there is that the 15 percent that's associated with the performance band either incentive or penalty would continue into years '12 and '13. However the DSI rider is to be set to zero.

Q. So it will be either a credit or

incentive buildup for the company in that year, even though the DSI has fallen off?

A. That's correct.

Q. Can you describe a -- the rear lot facilities to me? What constitutes a rear lot facility? Is it the existence of a transformer, a pole, a cutout, an animal guard. What, in fact, makes it a rear lot facility?

A. Sure. It would be all of those things. When I am talking about rear lots, if you think about a home setting here and a home setting here and the two property boundaries abutt each other, and then our facilities run right down through the back of those two -- of those two lots, so the poles, the conductors, all the things you mentioned, would be what I refer to as rear lot facilities as opposed to if the pole line was in the front of the house.

Q. So let's pretend I'm living on Elm Street in Cleveland. And I've got a wire running across my property. I have a fence that separates me from my neighbor in the rear.

The only thing transferring my property line there is a wire. I don't have any poles. I don't have any transformers. I don't have any animal guards. I don't have any arrestors.

Would I be subject to this rear lot reduction factor?

A. Your hypothetical example, I don't know the answer to that. What we've provided is that the 439 circuits that we would designate as rear lot would be identifying in advance. And so all --

Q. You haven't -- they haven't already been identified?

A. They have been identified internally to the company. We would need to provide that list of circuits to staff.

Q. And what criteria would you expect staff to review to determine whether, in fact, those 50 percent of the customers in a particular circuit were served via rear lot facilities?

A. Could you repeat the question?

(Record read.)

A. I don't know. I wouldn't want to speak for what the staff might do to verify that.

Q. Okay. Let's pretend I want to review it. I would like to know how you determine what a rear lot facility is.

You've come up with 439 circuits where 50 percent or more of the customers are served through rear lot facilities.

In order for me to evaluate for my client, I need to understand how you've done that. Can you tell me?

A. So are you asking me how we decided what was a rear lot circuit?

Q. Yes.

A. Yes. Okay. I can explain that.

So we took a look at -- at where the facilities lot -- where they were actually on the property lines, whether it was in the front of the house right adjacent to a main street or if it was in the rear of the house.

If it was in the rear of the house serving that customer in the rear lot, then we denoted that customer as a rear lot served customer.

We then took a look at the circuit and said if more than 50 percent of the customers were served from rear lot facilities on that particular circuit, then we designated that as a rear lot circuit.

Q. Sort of circular, isn't it?

Did you see -- did you have to see -- does the company need to see a particular type of facility, a pole, a transformer, a squirrel guard, a cutout, to determine that it's a rear lot facility?

A. I'm not trying to -- I am not trying to dodge your question. It's just so obvious to me. I have been in the rear lots and I know exactly what I've seen in the rear lots.

Q. You need to stay out of those rear lots, you will get in trouble.

A. Some are some areas you could get in trouble, but so it's very clear to me when we talk about rear lot facilities, I mean it's literally a pole line running through the -- every -- you know, through the rear of multiple homes.

Q. Okay. We will move on.

EXAMINER PRICE: One second, Mr. Reese.

Nonetheless getting back to my question earlier for the purposes of the incentive part of your DSI rider, that 15 percent, you are only going to count outages to those rear lot facilities half of what they actually are? A customer was out 60 minutes, you will only record 30 minutes?

THE WITNESS: That's right.

EXAMINER PRICE: And this is on top of the increasing the CEI target of 95 to 120?

THE WITNESS: That's right.

EXAMINER PRICE: Do you know why CEI target was initially set at 95?

THE WITNESS: I don't know that, sir.

EXAMINER PRICE: Do you know why they didn't have a rear lot -- any sort of rear lot reduction when they originally determined the target?

THE WITNESS: I don't know that either.

EXAMINER PRICE: Can you explain what has changed that the Commission should now change the target the way outage is calculated?

THE WITNESS: Well, when we look at CEI in all the factors, the age of the system, we really believe that the optimal point when we try to balance the cost to achieve the reliability and what -- and what it would ultimately cost the customers, we think that 120 is an optimal point.

We believe that 95 is just extremely aggressive, and whether you look at the rear lot facilities, we think that CEI is, quite frankly, different than all of the other utilities that we own and, quite frankly, we think it's probably different than many utilities around the country with all the rear lot facilities.

EXAMINER PRICE: Don't you think most utilities have some unique factor that they would characterize as to what makes them unique amongst all the other utilities?

THE WITNESS: Yes, I think that's probably correct, and I think that those utilities I think the way the Commission weighs proposed changes for storm exclusions and that sort of thing, I think works fine, and really what we're here to do is propose a change to our target as well as incorporate in the rear lot reduction factor.

EXAMINER PRICE: Thank you.

Mr. Reese.

Q. (By Mr. Reese) Moving to page 22 of the Application, I see on the third line here we are talking about the DSI -- well, starting on the second line, "The DSI rider shall not be considered a contribution in native construction or be used in determination of excessive earnings."

I'm particularly interested in this "determination of excessive earnings." Would that be a good question for Mr. Blank to answer why it would not be considered?

A. I think you could ask Dave that question.

Q. Do you know the answer -- do you understand it?

A. Yes, I understand the question.

Q. Okay. Can you explain why any revenue generated through the DSI rider should not be considered?

A. In general when we look at all the things we need to get down in our distribution system, you know, the things we have already talked about, replacing the aging infrastructure, bringing on the new employees, those things will all be very expensive for us.

And if you then take the revenue and apply that to excessive earnings, it wouldn't really fulfill its need for us to provide the financial health for the companies to be able to do those things.

Q. Isn't it still an incentive --

A. I'm sorry, isn't what still an incentive?

Q. The DSI.

A. Are you talking about the piece associated with the performance band or the kind of the base DSI?

Q. Well, the base DSI, unless and until you are found to be ex -- what's the term, excessive earnings, it's still an incentive, isn't it?

A. I wouldn't call the DSI the base piece the incentive. I don't want to get that confused. The base piece, the two-tenths of a cent per kilowatt is a revenue that we have proposed, the incentive piece that comes out at 15 percent plus or minus, that's the incentive piece that helps us ensure that our -- our reliability expectations are aligned with the customers' expectations.

EXAMINER PRICE: The base piece, the revenue.

THE WITNESS: Yes.

EXAMINER PRICE: Let's go back to your earlier comment this is not a cost based rider. How does CEI -- how does the companies propose that this be accounted for? Going to go into an account subject to audit by the staff?

THE WITNESS: Now, I think you will have to ask Dave Blank that question. I'm not familiar with how we'll account for it.

EXAMINER PRICE: Okay. What was your basis for saying it's not a cost basis rider?

THE WITNESS: My basis there is that my general understanding of ratemaking is that you need to show -- in standard ratemaking you need to show cost and then reimburse for cost.

EXAMINER PRICE: And since this is future expenditures --

THE WITNESS: That's right.

EXAMINER PRICE: That's why you are

saying it's not -- we will ask that question of Mr. Blank.

THE WITNESS: Correct.

Q. (By Mr. Reese) Finally, in paragraph G on page 22, the companies commit to making capital investments in their distribution system in the aggregate of at least $1 billion, and that's over a five-year period; is that correct?

A. You left out one pursuant to this plan so --

Q. With that word in there what's the answer?

A. Yes.

Q. Thank you.

And this says investments in the distribution system. Can you give me some examples of what those investments are that are specifically reliable related?

A. There would be a lot of them. For example, at CEI we have a program in place to harden the backbone to add sectionalization fusers and reclosers, we have an enhanced vegetation management program in all three operating companies.

EXAMINER PRICE: What enhanced vegetation, being capital expenditures?

THE WITNESS: There is a part of it that's capital, yes, sir.

Q. I want to ask you a couple of questions on Attachment E to the Application.

Now, as I understand it, Attachment E goes into some depth regarding some of the pieces of your testimony including the DSI and the smart grid study. Attachment E as I handed out to you is three pages long; is that correct?

A. That's right.

Q. Let's go to the second paragraph in Attachment E on the first page. The DSI rider is expected to provide adequate resources, okay. Let's stop there.

Are the resources that FirstEnergy -- the FirstEnergy companies have available at the current time inadequate?

A. When we look to the future and the things that we need to get done to ensure continued reliability of the system, we believe that we need additional revenues.

Q. So without the DSI, FirstEnergy would have inadequate resources to maintain healthy serious sustainable distribution utilities?

A. I wouldn't use the word "inadequate." I would say that it would be extremely difficult to get done all the things that we need to do to ensure the reliability for our customers.

Q. On the second sentence of that second paragraph you state, or the attachment reads, the DSI rider will ensure that customers' and companies' expectations are aligned.

How does the rider ensure that expectations are aligned?

A. We were referring to the fact that part of the rider includes the commitment for a billion dollars. It includes replacing of the aging infrastructure. Includes the hiring of the new employees. And it also has the performance band that ensures that we are aligned when it comes to reliability.

Q. I believe you just said that part of the rider includes the $1 billion. Did you misspeak there? I mean, your testimony supports the $1 billion, but that's not part of the rider, is it?

A. I see the rider and the billion dollars part and parcel of our ESP, so it's all part of our ESP.

Q. But the billion dollars is not part of the rider, correct?

A. That's correct.
Q. Thank you.
Let's continue with this sentence, second sentence, second paragraph.
And that the companies replacing sufficient emphasis on and dedicating sufficient resources to energy delivering and reliability.
So the DSI rider will help ensure that the companies' placing sufficient emphasis on its reliability?
A. The DSI rider is intended to provide a revenue that will allow us to do the things we need to do to continue to provide the reliability service.
Q. So without the rider, will the companies be able to provide reliable service?
A. It would be extremely difficult.
Q. Will the companies be able to provide reliable service without the rider?
A. It will be extremely difficult. I don't know.
Q. So if the Commission does not approve the rider, the company is unsure of whether it's-- it will be able to deliver reliable service to its customers?
MS. MILLER: Objection, your Honor. I

think the witness has answered this twice now.

EXAMINER PRICE: Sustained.

Q. Let's look at the third paragraph here on attachment E. The last sentence for the period 2012 through 2013, "The DSI rider will remain in place to effectuate any SAIDI performance adjustments."

Now, those SAIDI performance adjustments we are talking about are the 15 percent, somewhere within that 15 percent range up or down?

A. Yeah, what we are referring to here is that we have that performance band and it's capped at plus or minus 15 percent, and so that either penalty or incentive that's associated with the maximum 15 percent would continue for '12 and '13.

Q. Okay.

EXAMINER PRICE: I can understand why it would continue through '12. I don't understand why it would continue through '13. Because of the performance incentive in place for more than a year after it's adjusted?

THE WITNESS: It's based on the calendar year and it is evaluated by April 1 after the calendar year.

EXAMINER PRICE: I understand. Now, I think -- I think I understand. Thank you.

Q. (By Mr. Reese) Now, the -- under the SAIDI reliability target section you have a discussion about the existing targets of Ohio Edison and Toledo Edison and establishing a new SAIDI target for CEI; is that correct?

A. Yes, that's correct.

Q. By setting this new target, that will affect the targets that are set under Rule 10 of the ESSS; is that correct?

A. Our proposal would only have us change the SAIDI target for Rule 10.

Q. Do you know what other current reliability indices are part of your Rule 10 targets which other measures have targets?

A. I believe there are targets for CAIDI and SAIFI.

Q. And you are not proposing any change to SAIFI or CAIDI?

A. To the targets, no, only for SAIDI.

Q. And so the ESP, in fact, proposes a change to the ESSS or the companies' ESSS report; is that correct?

A. Could you repeat that?

Q. Yeah. Let me rephrase it.

Is it the companies' intention to modify its SAIDI target through the filing of this plan?

A. For CEI?

Q. For CEI.

A. Yes.

EXAMINER PRICE: Unless I'm mistaken, it was always my understanding that SAIDI is the product of CAIDI times SAIFI; is that correct?

THE WITNESS: That's correct.

EXAMINER PRICE: Why would you not since -- okay, since SAIDI then is derived from CAIDI and SAIFI, why would you leave your CAIDI and SAIFI targets unchanged?

THE WITNESS: Because the only thing in our ESP that is, you know, that we tie the performance to is SAIDI, so we believe that you can still treat the SAIFI and CAIDI through the existing ESSS rules, and the only thing we would have to change is SAIDI.

EXAMINER PRICE: Okay.

Q. (By Mr. Reese) Do you know how long CEI has had a SAIDI target of 95?

A. Not specifically, but I believe it's been at least the last five or seven years.

Q. Could it have been back to the mid-'90s even?

A. Could be.

Q. All right. Let's talk about the development of the rear lot reduction factor. Middle of the paragraph we are talking about restoration times that are roughly double for these rear lot facilities.

Do you see that? Fourth line down in the paragraph.

A. Yes, I see that.

Q. You say "roughly double." Can you give me a measurement?

A. Yes. When I went out and talked to a number of our crews that performed this work at CEI, we just talked about some hypothetical cases and I said so what kind of time does it take you if you had a failed cutout on a front line?

And they said that in general that would be somewhere around, say, an hour and a half. And I said so, now, what if it's a rear lot, and they said in general probably around three hours, about double.

Q. Did they tell you why?

A. Yeah. They gave me a lot of good examples. Probably the most striking one that I remember was when they talk about a front lot, they just simply pull up in their bucket truck, they make the area safe, they set the wheel chocks, they jump in the buckets and away they go.

When they go to the rear lot, first of all, they can't take their truck back there because of the driveways of the residence, it won't support the truck. So they have to do everything manually.

When they first get back to the rear lot, and a lot of cases there are obstacles, including one of the guys was telling me about dogs, and so you have got these dogs, the dog box is right where they will have a fence up and they will have the dog box there.

So they have got to get ahold of the customer to take care of the dog. Once they get the dog taken care of, then whatever they have to take to the rear lot, if it's a new cutoff, they have to drag it back. They have to climb the poles. So it takes about twice as long.

EXAMINER PRICE: Okay. That all sounds like a very anecdotal review. Have you performed any analytical studies which would demonstrate that rear lot outages take twice as long to perform?

THE WITNESS: That just comes from my experience, sir, just talking to my lineman. I don't do that work but I talked to several of the lineman and I went and actually visited them where they do this work.

EXAMINER PRICE: So the answer would be you haven't performed any analytical studies.

THE WITNESS: We did take a look at some analysis, I think we provided it in an interrogatory where we looked at some historical SAIDI performances and we looked at what we would consider rear lot versus front lot, and it proved out that .5 would be about the right number.

Q. (By Mr. Reese) Can you tell me any other companies that use a rear lot reduction factor when calculating the reliability of performance?

A. I don't know of any.

Q. And, again, the factor of .5 is because service restoration is roughly double; is that correct?

A. That's correct.

Q. Under the reliability reporting requirements on the second page of the Attachment E, you talk about all of the reporting requirements pursuant to OAC 4901.1-10. We will refer to that as an ESS from now on, if that's all right.

Each of the companies' SAIDI targets will be calculated -- calculated using the methodology which has been accepted by the Commission staff as of the filing of this plan.

That means what's currently on file with the staff as part of your annual ESSS filing?

A. I'm sorry, I didn't understand the question.

Q. Okay. You are referencing ESSS rule or chapter 10, the first two sentences here, that's the ESSS.

A. Yes.

Q. You state that the attachments states each of the companies' SAIDI targets will be calculated using the methodology which has been accepted by the staff as of the filing of this plan.

So this is the methodology accepted by the staff as of your last ESSS filing?

A. What we were trying articulate here is that we were not suggesting any changes to the major storm exclusion criteria.

Q. So that was specific to the major storm.

A. Correct.

Q. Okay. Now, the rear lot reduction factor would be applied for CEI to its targets under Rule 10; is that correct?

A. You wouldn't apply it to the targets.

You would apply it to the actual performance.

Q. So you would apply it to the minutes.

A. Correct.

Q. So if, in fact, the filing of this plan results in the Commission accepting 120 minutes as the new SAIDI targets for CEI, those 120 minutes will still be subject to the reduction factor; is that correct?

A. No. The target would be 120. And you would simply apply the rear lot reduction factor to the customer minutes of interruption on those circuits that we identify as rear lot circuits, so you wouldn't change the target. It would be -- it would be 120 minutes. You just compare your actual performance against that.

Q. Okay. So, in other words, the 120 minutes would be calculated differently for CEI than for Ohio Edison and Toledo Edison; is that correct?

A. No.

Q. It would not be calculated any differently even though a rear lot reduction factor is applied?

A. No. The targets -- the targets would just be established. They wouldn't be calculated. You just have 120 minutes as your target.

Q. The minutes, the total minutes of outages experienced by the CEI circuits, they go into -- let me rephrase that.

Down on the fifth line of this paragraph under "Reliability Reporting Requirements," in the case of CEI, a rear lot reduction factor would be applied to customer outage minutes; is that correct?

A. That's correct.

Q. So the customer outage minutes for CEI would be calculated differently than customer outage minutes for Ohio Edison or Toledo Edison; is that correct?

A. There would be no rear lot reduction factor applied to Ohio Edison or Toledo Edison.

Q. So they would be calculated differently, correct?

A. To the degree you don't have a rear lot reduction factor, yes.

Q. Finally, on this paragraph the Commission's approval on this plan shall constitute any waiver required for purposes of complying with the Ohio Administrative Code -- excuse me, with the Ohio Administrative Code with respect to establishing and calculating reliability indices and performance targets.

Now, that says a lot right there. Is that specific to one rule under the ESSS or does it apply to the entire ESSS?

That's a fairly broad statement. Let me give you an example.

Rule 10 deals with system reliability. Rule 11 deals with circuit reliability.

Is it the intention with the language here in Attachment E that approval of a plan would constitute waivers for any other rules other than the system reliability rules under Rule 10?

MS. MILLER: Objection, your Honor. I think that that's a mischaracterization of the scope of this sentence as it pertains to the ESSS rules. Not all of the ESSS rules pertain to reliability indices or performance targets.

It's actually Rule 10 that addresses those and in no other place in the ESSS rules would you find reliability indices and performance targets. It's specifically Rule 10 that addresses that.

EXAMINER PRICE: Well, actually, I think there is an element of reliable indices in Rule 11. I think that's why Mr. Reese was asking the question.

Your objection is overruled.

A. I'm not totally versed in all of the

rules. Maybe if you could ask me specific parts of the rules how this might change the rules, I could try to answer your question.

Q. Well, that's why I'm troubled by -- why I asked the question. The statement here, the sentence is very broad.

"Constitutes any waiver required for purposes of complying with the Ohio Administrative Code with respect to establishing and calculating reliability indices and performance targets."

In your testimony and in some of the other discussion we have had here today we've talked about a SAIDI performance target. And you've talked about a new target for CEI and SAIDI reliability targets for the three companies, three operating companies all set at 120 minutes.

Those are SAIDI performance measurements. And I believe what you're talking about there is system reliability, which is what's measured under Rule 10 of Chapter 10.

There is a separate rule, Rule 11, that is circuit specific that deals with, for instance, there is a requirement that the company report on its 8 percent worst performing circuits every year, and some of those measures that can be reported on include SAIDI, for instance.

Now, this sentence refers -- constitutes any waiver that talks about the Ohio Administrative Code. I just wondered if you meant that to be limited to Rule 10 that deals with system reliability.

A. In Rule 10 we would be looking to change the SAIDI target. We would be looking to incorporate the rear lot reduction factor.

In Rule 11 I believe that you have to -- you identify every year your 8 percent worst performing circuits

Q. That's right.

A. And so for CEI let's say there's something just north of a thousand circuits at CEI, I think it's a thousand-fifty-six, but just to keep the math simple, if it was a thousand circuits, we would still have to report our 80 worst performing circuits.

Q. But in -- but in reporting your -- your calculating which are your 80 worst performing circuits, would you incorporate the rear lot reduction factor or are you going -- does this waiver encompass asking for, for purposes of Rule 11, incorporating the rear lot reduction factor or are you going to calculate the minutes from those circuits a different way than you do for Rule 10?

A. No. We would calculate them the same, so it has the potential to change a circuit that would fall into that worst performing list. You would still have the eight worst performing or it may be different.

EXAMINER PRICE: CEI circuit that might otherwise fall within that 80 percent may not.

THE WITNESS: That's right.

EXAMINER PRICE: Are there any other instances that you know of off the top of your head where you are asking for where this request for a waiver would encompass part of Rule 10 or Rule 11 or anything else?

THE WITNESS: None that come to the top of my head.

Q. (By Mr. Reese) I'm looking at the second full paragraph, actually the first paragraph under SAIDI performance band.

Just looking at the last phrase, this talks about an adjustment to the DSI, "Nor shall it be construed as a punitive measure in response to inadequate service."

Can you tell me what you mean by that?

A. I'm sorry, I didn't catch up to where you were.

Q. Okay. It's the last full sentence of the second paragraph. "The performance band is set to achieve top quartile performance in the industry and, thus, a SAIDI financial adjustment that reduces the DSI rider does not represent nor shall it be construed as a punitive measure."

What does that mean? I am not quite sure why that's there.

A. We were simply articulating even at 135 minutes, if you go outside of 135 minutes there would be a financial adjustment, but that is still very good reliability. And so we wanted to articulate that it was not inadequate service.

Q. I'm looking -- I'm in your testimony at page 4.

A. Okay, I'm there.

Q. All right, I'm looking at page -- I'm sorry, lines 14 to 17, which deals with the -- the rider and the fact that the rider will provide the companies' financial wherewithal to remain healthy and capable of continuing their ongoing commitments to the energy delivery and customer service business.

Do you see that?

A. I do.

Q. Does this imply that the company won't continue its ongoing commitments to the energy delivery and customer service business if the DSIR is not approved?

A. Could you read that back, please.

(Record read.)

A. We will work very hard to continue to meet the needs of our customers, but as I start there on line 13, it's going to be very difficult. The challenges that we face put us in a position where we -- we need the revenue associated with the DSI rider.

Q. Okay. Thank you.

Now, in your testimony you've proposed this performance band. Do you know offhand, based on performance over the last five years, let's go back to 2003, whether the companies' SAIDI performance have fallen outside that band at any time, and if so, which companies?

A. I recall that we did provide an interrogatory, so I'm going to go by memory. I don't have the number in front of me, but I believe that in the previous five years CEI would have been above the 135 two years, and I believe Toledo Edison would have been below the 90 one year.

Q. Now, with the Application of the rear lot reduction factor, would CEI have still fallen outside the upper band?

A. Again, I think that was a question that was asked in an interrogatory and we provided an answer. I believe -- I'm going by memory because I don't have that in front of me.

I believe there was still at least one year that with the rear lot reduction factor, it may have been two, one or two years that CEI would have still been above the 135 minutes, you know, looking back over the last five.

Q. Did you look at historical performance when establishing a performance band?

A. The proposed performance band?

Q. Yes.

A. Yes.

Q. And 90 to 135 was established why? Because -- just give me an idea why you came up with that particular range.

A. You have to start with we established first the target of 120 minutes. Again, we think that that's the optimal spot when you are trying to balance reliability and cost to obtain.

We then wanted to establish an asymmetrical band around that 120 minutes, so we established 90 on the bottom side that so you would have to go from 120 down to 90 before you would get an incentive payment.

On the upside you would have to go only 15 minutes to be in a penalty, so it would be asymmetric and it would be skewed to benefit the customers.

In addition to that, when you look at 90 minutes, that is very close to top decile performance in the IEEE study, and the 135 is just slightly out of top quartile.

Q. Let's go to page 8 of your testimony. Looking at line 6, "A performance range is typically a symmetrical band that recognizes that with changing weather conditions and other factors outside the companies' control using an absolute number as a performance criterion is not practical."

Do you see that?

A. I do.

Q. Isn't that really what's done with SAIDI, CAIDI, SAIFI, and other performance measures that are part of the ESSS? Aren't the targets absolute numbers?

A. Today, you are referring to in today's environment?

Q. No.

A. Yes. They just have a single number.

Q. And you are not proposing that the ESSS change, are you, in terms of their being an absolute number for a target?

A. Other than what we have already talked about, which we changed CEI's target to the 120, no, for SAIDI.

Q. So using an absolute number as a performance criterion is practical for the ESSS, but not for calculation of the DSIR; is that correct?

A. I didn't make any mention of what ESSS should be. I'm just saying that when I look at performance of a distribution system, I think that a band is more practical than an absolute number.

Q. Well, you are talking about SAIDI targets and there are SAIDI targets in the ESSS and so you are just saying having a target in the ESSS is not practical?

A. I didn't say that.

Q. Oh, okay. I have just a couple of questions remaining.

This regards the Smart Grid Study. You

reference a Smart Grid Study in your testimony; is that correct?

A. That's correct.

Q. I take it the companies are going to pay for this study; is that correct?

A. That's correct.

Q. Do you have an estimated cost for this study?

A. I believe it would be less than a million dollars per company.

Q. Now, your testimony states the study will be completed by December 31 of 2009. Do you know when the study will begin?

A. No, other than the fact that we'll -- we'll start it soon enough to make sure that it's completed by the end of 2009.

Q. If you know, how will the Smart Grid Study interface with the AMI pilot program and the dynamic pricing pilot program also proposed by the companies?

A. At this point I don't know. One of the things we will need to do as we start to prepare to take this study on is we will have to interview some companies that provide that kind of service and we'll look to them to provide us some guidance on where they may see some touch points.

Q. Do you know if this study includes a cost/benefit analysis?

A. It will.

Q. Do you know if this study will estimate operational savings, demand response, avoided cost savings, and customer benefits?

A. That I don't know until I talk to some of the suppliers of this kind of service and get an understanding -- we will just need some guidance there on how far to go with this study and we will have to talk to the experts to get that guidance.

Q. So has the companies selected a consultant to do the study?

A. We have not.

MR. REESE: One second, please.

No further questions.

EXAMINER PRICE: Thank you.

Mr. White?

MR. WHITE: No further questions.

EXAMINER PRICE: Ms. Wung.

THE WITNESS: Yes, your Honor, just a few.

- - -

CROSS-EXAMINATION

By Ms. Wung

Q. Good afternoon, Mr. Schneider.

A. Good afternoon.

Q. My name is Grace Wung. I am here on behalf of The Commercial Group, which is a group of commercial end users.

EXAMINER PIRIK: You need to pull the microphone closer.

Q. Is this better, can you hear me now?

A. Yes.

Q. I just have one follow-up question to Mr. Reese's question.

Do you recall his question with regards to past performance, SAIDI performance in the past five years?

A. Yes.

Q. And you gave an example of TE being below 95 for one, CEI being 135 for two years?

A. To my recollection, again, we provided an interrogatory and I looked at those numbers probably three weeks ago, so I'm just going by memory.

Q. Okay. Thank you for the using the best of your recollection.

If you were to take those past

performances for the operating companies and placed them in the current performance band under your ESP current proposal, is there any year in which the companies would have received a perform, an incentive under the new plan based on past year performances?

A. Going by memory, I think there was one year that Toledo Edison may have been a couple minutes better than the 90 cutoff, so if there wasn't -- what I can't remember, was there an offset at CEI in that particular year.

But to the degree that we would have received a performance payout in any of the five years, it would be very small. Because it was only a couple of minutes better than the target.

Q. And actually --

A. I'm sorry, than the lower end of the performance band.

Q. Going back to that -- let's go back to the lower end of this performance band and Mr. Reese and I think the Hearing Examiner asked you this question, how exactly are you guys determining what is the -- let me back up.

Would you believe it's safe to say SAIDI is a measure of a service quality?

A. I wouldn't define it as service quality.

I mean SAIDI is System Average Interruption Duration Index.

Q. So you -- but it is a performance your of performance?

A. It is a measure of reliability performance, yes.

Q. And, again, going back to that measure of reliability performance, how exactly would you classify a level that's too low or a level that's too high?

A. I wouldn't qualify a level that's too high or too low.

Q. There's no specific criteria that you would use?

How did you -- again, how did you get to the 95 to 120?

A. Yes, the bandwidth we talked a little bit about, again, if you look at the 2006 IEEE study, they looked at I think it was 100 or 102 utilities around the country, they used the 2-1/2 Beta methodology and they established that I think top quartile, the cutoff was like 102 minutes.

You know, below 102 would be in the top quartile, in fact, I think the top decile was I believe it was like 89 or 88 minutes, so when we established 90, that would be among the very best in the country.

MS. WUNG: Thank you, Mr. Schneider. I have no other questions.

EXAMINER PRICE: I keep waiting for the hearsay objection from the parties and I don't hear it on the study.

Can you give a cite to that study that you are -- I know it's referenced at page 9 of your testimony, but can you give the title more kind of a where can the parties find this study?

THE WITNESS: I believe we did provide that -- that study as part of an interrogatory, but IEEE is the Institute of Electrical and Electronic Engineers, and so you could go on their website, I believe, and look for that study.

EXAMINER PRICE: Thank you.

Ms. McAlister.

MS. McALISTER: I have no questions, your Honor.

EXAMINER PRICE: Ms. Fonner.

MS. FONNER: Very briefly.

- - -

CROSS-EXAMINATION

By Ms. Fonner:

Q. Good afternoon, Mr. Schneider. I'm Cynthia Fonner from Constellation Energy.

A. Good afternoon.

Q. I have just a few questions for you.

With respect to SAIDI, can you tell me currently is SAIDI performance a component of the compensation of any employee of FirstEnergy?

A. Yes, it is.

Q. And is that a plan that employs -- that applies to all employees of FirstEnergy?

A. We actually have two different places that SAIDI performance shows up. We have what's called a short-term incentive compensation program that I participate in, and SAIDI is a direct link to my performance or to my incentive compensation.

In addition to that we have a 401K matching plan that all employees at FirstEnergy participate in, and there's a -- a metric there called operational performance, and SAIDI performance resides in that. And that would apply to all employees that participate in the 401K.

Q. Turning now to the Smart Grid, if I wanted any information regarding what the study plan was, the proposal, the components, I would find that in Attachment E to the Application; is that correct?

A. To the degree we have developed it thus far, I would say that we -- we haven't developed a full flow working document to articulate what that study would entail.

Q. But to the extent it has been developed, everything is in Attachment E?

A. I believe that's correct.

Q. Would you say that there is a fair level of interest in the Smart Grid at the national level?

A. Yes, I would say that's true.

Q. And you are familiar with the fact that NARUC and FERC have a joint collaborative regarding the Smart Grid?

A. I am not familiar with that.

Q. Are you familiar with the fact that other jurisdictions, they're three electric distribution utilities, are in the process of posting workshops, collaborative workshops regarding Smart Grid?

A. Again, I believe there is a -- there is a fair amount of interest in Smart Grid around the industry.

Q. And is it your position that the companies would not undertake a smart -- a study of

Smart Grid technology but for the ESP?

A. I don't know the answer to that.

Q. And just to be clear, FES's proposal is not a collaborative study in any way, correct, it's something that would be internally only?

A. That's correct.

Q. And in terms of the entities with whom you would share those results, that is limited to Commission staff and OCC?

And just for reference, I'm -- my question is based upon page 11 of your testimony, lines 9 through 11.

A. That's correct, we would share it with the Commission staff and the OCC.

Q. And that's all. Nobody else.

A. That's all that we've proposed.

MS. FONNER: Thank you. Nothing further.

EXAMINER PRICE: Mr. Smith.

MR. SMITH: No questions.

EXAMINER PRICE: Mr. Breitschwerdt.

MR. BREITSCHWERDT: Just a very few.

\- - -

CROSS-EXAMINATION

By Mr. Breitschwerdt:

Q. At the very beginning of OCC

discussion -- good afternoon. My name is Brett Breitschwerdt. I am here on behalf of NOPEC and Ohio School's Council.

At the very beginning of the discussion you were referenced to the Application, page 21, Section E. If you could turn there, I just have a very few questions.

You talked with Mr. Reese on behalf of OCC about the need to train new employees to replace retirees.

Do you recall that discussion?

A. I do.

Q. And you discussed the PCI program.

Do you recall that?

A. I do.

Q. And PCI, what does that stand for again?

A. Power Systems Institute.

Q. Okay. And the candidates for involvement in Power Systems Institute would be high school graduates?

A. Primarily. The nature of PSI it's -- it's a full day, so it -- you know, when you go off to class, it's five full days, so it makes it very difficult to -- an individual that may already have a job, may have a family, that sort of thing, it's difficult for those individuals, so primarily we target high schools.

Q. I see. Okay.

And when you say "target high schools," that means target for candidates to enroll in the program?

A. Correct, recruit from high schools.

Q. And would those high schools be in the companies' service territories?

A. Yes.

Q. Outside the service territories as well or just within the service territories?

A. There may be a few high schools that are outside of the territory. An area that comes to my mind is we have a school associated with Youngstown State University in Youngstown, Ohio, and if you go about 30 miles south of Youngstown, you actually leave our service territory. We may do some recruiting in those high schools, but it would be primarily our service territory.

Q. So approximate percentage of high schools then outside, say, 95 percent within the territories of the companies?

A. I don't know.

Q. That's okay. That's fine.

And for the PSI program what type of skills do you seek from these high schools students that are candidates? Can you just kind of give an overview of what you expect?

A. Sure. When we go out and recruit, one of the things that we do is we invite these individuals to come out to one of our climbing schools if we are talking about a lineman. We also have substation.

If we are just talking about linemen, we invite them to come out and we look at their physical capabilities, can they climb a pole, are they comfortable on a pole, and then as we progress, we then also have some entrance exams, if you will, to see if they have the analytical ability to become a lineman.

Q. So mathematics or kind of --

A. Correct.

Q. -- academic aptitudes?

A. Correct.

Q. Would you agree with me that there is a benefit to the Ohio utilities of public school districts within the companies' service territories effectively educating the students and preparing them for the work force?

A. I think that would be a benefit to the utilities and nonutilities to have kids coming out of high school that are prepared to enter the work force, yes.

MR. BREITSCHWERDT: That's all I have. Thank you.

EXAMINER PRICE: Mr. Stinson.

MR. STINSON: No questions, your Honor.

EXAMINER PRICE: Mr. Lavanga.

MR. LAVANGA: No questions, your Honor.

EXAMINER PRICE: Mr. Dunn.

MR. DUNN: Yes, your Honor, just a couple.

- - -

CROSS-EXAMINATION

By Mr. Dunn:

Q. Mr. Schneider, my name is Greg Dunn. I'm representing the City of Cleveland. Just got a couple of questions mostly on --

A. I'm sorry, I'm having trouble hearing you.

EXAMINER PRICE: Pass one of our microphones down.

MR. DUNN: I just don't have enough energy for the Langdon Bell method.

Q. Good afternoon, Mr. Schneider. My name is Greg Dunn. I'm representing the City of Cleveland. I have a couple of questions about the rear lot reduction factors.

Did I hear you say that there are 439 circuits in CEI that have -- that you have identified as rear lot circuits?

A. I'm going by memory. I believe that number is correct.

Q. And that -- you did testify the company has identified them?

A. That's correct.

Q. And are you providing that to staff or will you be providing that to staff?

A. We have not provided it yet, but we would provide it to staff.

Q. And when would you be doing so?

A. I don't know.

Q. Would you be willing to do so in the very near future?

A. Yes. I think all the -- I think all they would have to do is request it, to tell you the truth.

Q. Well, I think we will be doing so.

How many of these 439 circuits are in the city of Cleveland? If you know.

A. I don't know.

Q. And did you testify that the restoration times on these rear lot circuits are roughly double the restoration times on other circuits?

A. That's correct.

Q. And in your page 10 you testified that at least $1 billion will be spent to address distribution system improvements.

A. You are referring to page 10 of your testimony?

Q. Yes, sir.

A. Line 6?

Q. Yes, sir.

A. Yes.

Q. And, well, of that billion dollars, well, can any of that money be spent to improve the restoration times on these rear lot circuits?

A. We've not specifically articulated pieces of the billion dollars. So I just don't know sitting here today what -- what part of the billion dollars may be spent to improve the restoration time.

Q. Can improvements be made on those rear lot circuits that will improve restoration time?

A. Things can be done. I'm just not sure that they -- to improve restoration time it takes investment in more equipment, for example, and what I'm struggling with is I would want to look at the economic analysis to determine whether or not that's the best place in the interest of our customers to spend the money.

Q. When you say "in the interest of your customers," what do you mean there?

A. Well, when we do a -- an evaluation of where to spend our capital, we use a what I think is a pretty sophistocated methodology of racking and stacking one project against another project for any of the capital expenditures.

So in this particular case you may be comparing, say, a track vehicle, an additional track vehicle that you can use in a rear lot facility compared to a recloser that would limit the customers' affect when we have trouble.

So we would want to rack and stack all of those capital investments, and I'm just not sure where some of the things that you would do to improve restoration time would, you know, would stack out compared to other things.

Q. So theoretically, customers in these rear lots may not have their situation improved, but the billion dollars in the restoration times improved --

A. I don't know that their restoration time would be improved, but the billion dollars would improve, it's designed to improve the overall reliability of the system, so obviously, one of the things you do is work to reduce the number of outages in the first place.

Q. And you have been out at some of these rear lot circuits and have observed the types of housing and lot size?

A. Correct.

Q. And would you say that these are small lots on average?

A. Generally speaking, yes.

Q. And they have a higher density per plant mile than is normal in your service area?

A. I want to make sure I understand your question. Could you perhaps rephrase it?

Q. Sure, I would be glad to.

There are -- there is less plant per customer in these customers than on your average.

A. I don't know about on average. If you compare two communities, communities that have lots of rear lot. You have a higher customer count for those facilities than a rural area, say, out towards Ashtabula.

So I would agree in general that the areas that have rear lot facilities would have a higher customer density per plant. I just don't know on average.

Q. Thank you.

And are there certain maintenance advantages to high density?

A. From a maintenance perspective, these rear lot facilities are extremely difficult to maintain.

Q. By the question, though, is that there are advantages to higher densities, that you have less plant to maintain.

A. I would have to do an analysis around that. The top of my head I think that the difficulty you have in maintaining those rear lot facilities outweighs the fact that you have higher density of customers.

I understand where you are -- what you are thinking.

Q. And you have not done that analysis?

A. I have not done that analysis.

Q. But we don't know if there are certain advantages to maintenance in high density areas?

A. I have not done an analysis. I do

believe my opinion would be, just sitting here thinking about it, that the difficulties that we have in maintaining those facilities outweighs the fact that you have higher customer density.

Q. But you have not in your testimony factored in any of those advantages whereas you've -- you've considered the disadvantage.

A. I wouldn't say we didn't factor any of that in. I think the rear lot reduction factor that you are talking about, is that what you are talking about in my testimony?

Q. Yes.

A. That was purely based on the restoration time that it takes about twice as long to restore power on a rear lot facility.

MR. DUNN: That's all I have, your Honor.

EXAMINER PRICE: Thank you.

Mr. Bell?

MR. BELL: I am not going to let you down.

- - -

CROSS-EXAMINATION

By Mr. Bell:

Q. Good afternoon, Mr. Schneider. I guess I'm the cleanup batter for the time being.

A. Good afternoon.

Q. I'm Langdon Bell, representing the Ohio Manufacturers Association. Just a couple of pickups.

Would you agree that ESSS is directed toward absolute reliability without regard to the cost or the revenues associated with securing improved performance?

A. I don't know what all went into the ESSS targets that were established.

Q. Would you agree that your DSI rider is primarily directed toward the generation of revenue?

A. No, I wouldn't agree with that.

Q. Did I understand you correctly to state that the DSI rider is projected to generate something in the order of $115 million?

A. Per year, that's correct.

Q. And did I understand that the performance adjustment component is only 15 percent of that?

A. It has a kind of a cap and a ceiling, yes, of 15 percent.

Q. So that that 15 percent applied to the 115 million would place FirstEnergy companies at risk, since we have been measuring risk throughout these proceedings or perceived risks at the 16.25 million applying the 15 percent factor of the total dollars, correct?

A. Are you just taking the 115 million that I said was roughly what was represented by the DSI rider?

Q. What was to be generated, yes.

A. Multiply that times 15 percent.

Q. That's correct.

A. And you are saying that's the maximum penalty that we would pay?

Q. That's correct. Or the maximum reward you would receive.

A. That --

Q. That is the amount you are "at risk?"

A. I wouldn't quantify -- I wouldn't use the term "at risk."

Again, I think that there is a cap both on the incentive, the potential incentive and there is a cap on the penalty side. I wouldn't say that it's risk.

Q. And with respect to the performance band that you have, I thought you had indicated there is only a slight chance that you would be rewarded; isn't that correct?

A. No, I don't believe that's correct. I think you may be referring to a question that I answered earlier where somebody was asking me about the historical performance and whether or not we would have been in --

Q. Utilizing your past experience as representing your future exposure, you have a slight chance of being rewarded, correct?

A. When you look at our historical performance.

Q. Yes.

A. Again, I believe there was a year or perhaps two years that we would have been -- we would have had a slight incentive payment at Toledo Edison that would have also been one or two years that we would have been into a penalty situation at CEI.

Q. So that with respect to the overall revenues that are generated from three companies, not two, you would have a slight chance of being rewarded in Toledo Edison a slight chance of being penalized in CEI, and Ohio Edison would be, what, pure revenue? Given the performance bands that you have established based upon historical practice?

A. I don't think you can necessarily use the historical performance as a -- as a proxy for what we would have going forward.

Q. You can't use the historical performance as a proxy. Didn't you, Mr. Schneider, go out and talk to your linemen and say how -- as far as your historical performance, how much longer has it taken you in the past to service a rear lot versus a front lot because the line runs on the back of the property as opposed to the front of the property?

MS. MILLER: Objection, your Honor. Argumentative.

EXAMINER PRICE: Overruled.

A. I am not sure what your question was.

Q. I think the question speaks for itself.

With respect to this billion dollars in capital commitment, that billion dollars of commitment is suggested in my friend Greg's inquiry of view isn't directly related in any way, shape, or form to the improvement of reliability on the distribution system, is it?

A. I'm sorry, could you read the question back.

(Record read.)

A. I don't agree with that.

Q. All right. Let me follow-up Mr. Dunn's inquiry of you.

Your background is with CEI. I have got a lot of background with CEI as well. Doesn't CEI and hasn't CEI experienced substantial capital investments associated with just moving customers Plain Dealer facility moving, as I recall that illustration was utilized in a past case where you weren't securing a new customer, you were just following the load, so to speak, from one location to another?

If the capital expenditure is made simply to follow that customer's load, where is there an improvement, measurable improvement in reliability?

A. There was a lot there. Could you maybe just ask me one question at a time?

Q. Yes. When you -- when the capital investment is made to follow load, where is there an improvement in reliability?

A. I'm not familiar with the example you are giving.

Q. Let me give you another example. I can give you lots of examples, Mr. Schneider.

Much of the distribution capital investment made by CEI in recent years has been to serve new load in the southern suburbs in Richland, in Medina, in Strongsville, has it not?

MS. MILLER: Objection, your Honor. Assuming facts not in the record.

MR. BELL: I am asking the witness.
EXAMINER PRICE: Exactly. Overruled.
MR. BELL: It's his service territory, they are making the capital investment.
EXAMINER PRICE: Mr. Bell.
MR. BELL: Apologize.
A. If you are asking me do we have to invest capital to --
Q. Serve new load?
A. To serve any load, the answer is yes.
Q. With respect to those dollars of investments, assuming you make them billion dollar investments to serve a growing service territory in Medina County, how does that improve the reliability in Cuyahoga County and specifically the city of Cleveland?
A. If you are asking me does spending dollars in Medina County help the City of Cleveland's reliability; is that what the question is?
Q. You can so interpret it.
A. I can think of a couple of examples perhaps that spending money in Medina County could help the reliability of --
Q. Might conceivably.
A. I can think of a couple of examples. Or

at least one example.

Q. Doesn't your basic premise give us more money, this DSI rider is directed towards the generation of revenue and in view of the fact we will have more money available, we perhaps can spend it on improving the reliability to existing customers?

MS. MILLER: Again, objection, your Honor. Argumentative.

EXAMINER PRICE: Sustained.

MR. BELL: No further questions.

EXAMINER PRICE: Thank you.

Staff?

MR. WRIGHT: Thank you, your Honor. I will try to eliminate some.

\- - -

CROSS-EXAMINATION

By Mr. Wright:

Q. My name is Bill Wright, Mr. Schneider. I represent the Commission staff.

Let's start with the rear lot reduction factor. If you know, you may have been asked this before, you are not aware, are you, that -- of any other state that has such an adjustment?

A. No, I am not aware of.

Q. And you would agree with me, certainly, that the challenges as you have laid them out in your testimony, all utilities face those to one extent or another? If you know.

A. We, I think that CEI is very unique in the magnitude of facilities that are served by rear lots.

Q. You have not studied any other utilities in this regard in the state of Ohio, have you?

A. We have looked at Toledo Edison. Is that still on Toledo Edison and Ohio Edison and there's --

Q. I'm sorry, no, on FirstEnergy.

A. Not in detail we have not.

Q. Okay. And this is not a new problem, these are not new challenges for CEI. They have faced these for years, have they not?

A. That's correct.

EXAMINER PRICE: Off the record one minute.

(Discussion off the record.)

Q. You are proposing in this case to change the -- to increase by I believe approximately 26 percent the SAIDI reliability index for CEI; is that right?

A. That's correct, our proposal would be to establish 120 as the SAIDI target.

EXAMINER PRICE: Mr. Wright, can you turn your microphone on?

MR. WRIGHT: Oh, I'm sorry. How do you do that?

EXAMINER PIRIK: It's in the back.

EXAMINER PRICE: Mr. Lavanga will turn on Mr. Wright's microphone.

MR. WRIGHT: There's nothing back here. I will try to speak up.

EXAMINER PRICE: Okay. That's fine.

Q. (By Mr. Wright) One will suffice.

I believe you've testified earlier, have you not, that you are not aware when the existing CEI SAIDI target was established; is that right?

A. That's correct.

Q. You had no part in that?

A. I did not.

Q. Are you aware whether or not that target was actually proposed by CEI?

A. I don't know.

Q. Do you believe that reliability targets should be aggressive?

A. I believe that reliability targets should reflect the -- the point that is optimal when you are trying to balance the reliability of the system and the cost to incur.

Q. Okay. Let's talk about that for just a minute. Optimal, as you describe it, would compare the cost of the company I guess to achieve a particular result with the cost of the customer; is that how you are using that term?

A. I'm sorry, could you read that back.

MR. WRIGHT: Repeat the question, please.

(Record read.)

A. No. Really what I was -- I was -- what I was thinking about was the cost you have to spend to achieve -- you are trying to balance that and you have to look at each of the systems kind of independently, if you will, so, you know, an older system like CEI's is going to be more difficult to achieve low levels of SAIDI than, you know, perhaps a brand new system.

And so what you are trying to do is balance off what it's going to ultimately cost the customers for that reliability.

Q. Okay. Now, you are proposing under the DSI rider you would have -- I will use the term dead band that would extend from approximately 90 to 135 minutes under which there would be no penalty or reward; is that right?

A. That's correct. We established a performance band.

Q. So that if the DSI rider performance standard were adopted, the company could actually not meet its new SAIDI target of 120 minutes and yet still not be penalized, correct?

A. The penalty would -- you wouldn't incur a penalty until you got out of the 135 minutes.

Q. Which -- which is in excess of the 120 SAIDI target that the company is proposing in this case, correct?

A. That's correct.

Q. So why would 135 not be an optimal level for the company? In as much as there is no risk to the company up to that point?

A. Again, when I refer to 120 minutes as the optimal target, I believe that that represents excellent value for our customers to balances off the reliability performance with the cost to achieve.

I also believe that you need to have a performance band around that to take into account things that are outside of our control, like weather, for example.

Q. As you define what's optimal though under those circumstances, how is -- how is that optimal level compromised anyway, it's not costing any company any more? The company is not being penalized as well, correct?

A. I'm sorry, I don't understand the question.

Q. I will withdraw the question.

Much of your testimony, I believe, is premised upon trying to do what will align company interest and customer interest; is that fair?

A. Yes.

Q. Now, the -- I apologize for jumping around, this is something I forgot a moment ago.

With respect to the rear lot reduction factor, the affect of that, were it to be applied, would be to understate, intentionally understate the companies' response time in rear lot situations; is that not correct?

A. No, that's not correct.

Q. Isn't the companies' proposal to reduce the response restoration minutes by approximately a factor of .5 or one-half regardless of what the actual response is?

A. For purposes of calculating SAIDI, yes. Just to be clear, we would -- we would submit the -- the raw numbers and then the adjusted numbers just the same as we do for, say, major storm exclusions today.

Q. You anticipated my next question, but for purposes of evaluating the companies' performance under SAIDI, we would be looking at the net minutes, the net being after the rear lot reduction factor was applied, correct? I believe that's what you just said.

A. For purposes of seeing where you would fall in the performance band, for example?

Q. Yes.

A. That's correct.

Q. Is it your testimony that SAIDI is a su -- a superior reliability indicator to either SAIFI or CAIDI?

A. No.

Q. Okay. Let's turn to your testimony for a minute. Is it fair to say that, Mr. Schneider, that most of your background has been in plant -- plant-related activities and fuel acquisition?

A. The majority of my career has been spent in the power plants, that's correct.

Q. Okay. Now, turning to page 3 of your testimony, the first question and answer there, you talk about a number of different types of equipment

that comprise the companies' distribution system.
FirstEnergy already has a program in place to maintain its distribution system, does it not? It has for some time?
A. I am not sure what you mean by "a program in place."
Q. Well, the company -- I assume you receive a budget, an annual budget, do you not? To -- that it would be used, among other things, to -- to perform maintenance on existing distribution systems for the operating companies?
A. We develop an annual budget both O and M budget and a capital budget.
Q. Okay. And is it not correct that that budget is currently funded through customer rates? And I know you are not appearing as rate design or rate expert.
A. I don't know that I can answer that question. As you said, I'm not a rate design expert.
Q. Do you know where the funds come from that are budgeted to you of budgeting cycle for purposes of capital and O and M for the distribution system?
A. I would say they come from a variety of sources, including revenue from the customers,

including funds that we borrow from banks.

Q. Now, the items that you mentioned -- well, strike that. Strike that.

You say at line 7, you mention 8 -- approximately 8,000 energy delivery and customer service employees. Could you define for me what you mean by "customer service employee"?

MS. MILLER: Clarify, we are still on page 3?

MR. WRIGHT: Excuse me?

MS. MILLER: We are still on page 3?

MR. WRIGHT: Yes, page 3, line 7.

A. There is two ways to look at customer service. We have a department that reports to me that's a customer service department in the general sense and all of the employees serve the customer.

Q. I believe my question was as you use the term "customer service employee," is that something different than an energy delivery employee?

A. Yeah. In my testimony I was referring to the group of individuals that are in the customer services organization that also reports to me.

Q. Those would -- those would be people I assume handling customer complaints and other types of customer issues as opposed to the people out in the field working on outages and things like that; is that correct?

A. That's correct.

Q. Okay.

MR. WRIGHT: If I may have just a moment, your Honor.

EXAMINER PRICE: Certainly.

Q. Turning to page 10 of your testimony, the first question and answer on that page. This is the so-called $1 billion commitment.

What if any portion of this $1 billion is incremental to -- to capital spending that's already been budgeted for the companies over the next five years? If you know.

A. Could you rephrase that?

MR. WRIGHT: Could you read the question back, please.

(Record read.)

A. You are comparing apples to oranges there. Whatever we have in a budget --

EXAMINER PRICE: Please answer his question directly.

A. I don't know.

EXAMINER PRICE: Mr. Schneider, you are senior vice president for energy delivery.

THE WITNESS: Yes, sir.

EXAMINER PRICE: Do you have a capital budget plan for the next five years?

THE WITNESS: We have a capital budget plan. We don't have a capital budget approved, sir.

EXAMINER PRICE: Okay. To what degree does the $1 billion talked about in your testimony on page 10, is that over and above what's already planned in your capital budget?

THE WITNESS: The problem I'm having is the billion dollars that we talk about here is a commitment. We are saying that we will spend a billion dollars.

The fact that we have a five-year budget that has not been approved by our Board of Directors, for example, is not a commitment. I'm having trouble even trying to compare the two.

EXAMINER PRICE: That's fine. Thank you.

Mr. Wright.

Q. How does the $1 billion commitment compare with capital expenditures for the companies over the next -- excuse me, over the, say, the previous two or three years if those expenditures were maintained at or about the same levels? If you know.

A. I don't -- I don't know.

MR. WRIGHT: That's fine. That's fine. Okay one minute, your Honor. I know it's late.

THE WITNESS: Could we back up to that previous question?

EXAMINER PRICE: I am sure that --

MR. WRIGHT: There is not a question pending.

EXAMINER PRICE: I am sure on redirect your counsel will be happy to ask you any questions you would like asked.

MS. MILLER: I will.

MR. WRIGHT: No further questions. Thank you.

EXAMINER PRICE: Thank you.

\- - -

EXAMINATION

By Examiner Pirik:

Q. I have just a couple of questions. I want to follow up on something Mr. Wright asked you because I want to understand that the SAIDI target is 120. Correct?

A. The target that we are proposing.

Q. For all three companies is 120.

A. That's correct.

Q. So to the extent that the SAIDI that is calculated falls between 120 and 135, the companies aren't asking for insulation for -- from any type of action or proceeding from the Commission or whatnot with regard to the fact that they didn't hit their target at 125, are they? Or 120, I'm sorry.

A. We are asking that for CEI that ESSS target be changed to 120 for SAIDI. No change to CAIDI or SAIFI.

Q. Correct. That's not my question.

My question is the SAIDI target is 125 and then you have this performance band of 90 to 135. That performance band doesn't prohibit the Commission in any way from, say, your SAIDI is 130.

Just because it's within that performance band doesn't mean that there isn't some action -- the company is not asking for a waiver of action from the Commission if the SAIDI is above 125 -- or 120. The only purpose for that band is the financial incentive

A. Yes, I see what you are saying. At one point, your Honor, I think you said 125, just to be clear.

Q. Right, I keep correcting it.

A. It's 120, and that would be the target that we would ask to have changed in ESS. And so if -- if we posted a 130, for example, outside of what the ESP covers, we are not proposing anything there other than to change the target.

Q. So you are not asking the Commission to waive the possibility of some action that they could follow through on if you -- if, in fact, your SAIDI comes out at 130.

A. That's correct.

Q. Okay. The only purpose of that 90 to 135 band is the financial incentive; is that correct?

A. That's correct.

Q. The target 120.

A. The target is 120, that's correct.

Q. I just wanted to be sure I understood that.

Now, going over to the Smart Grid Study that you intend on doing, are you aware that -- that there have been discussions in various industries of perhaps the gas industry piggybacking on Smart Grid-type technology that could be developed by the electric companies?

A. I'm not aware of that.

Q. Do you know whether or not -- I mean, if, in fact, that is, you know, those types of technologies are of interest to the Commission, would -- is that in any way going to be part of the study as far as the potential for having those types of industries piggyback on the technologies that you all will be looking into?

A. When we laid this out, we haven't thought of that, but then, again, we haven't talked to some of the experts, so they -- we may find in fact they suggest something around that.

I just -- at this point I don't know because we haven't had those discussions.

EXAMINER PIRIK: That's all I had.

- - -

EXAMINATION

By Examiner Price:

Q. Actually before we go on to redirect, I have something that's just -- I'm just asking this so the record's clear.

Can you define in simple terms what SAIDI measures?

A. SAIDI.

Q. State --

A. Average Interruption Index.

Q. Yes.

A. So it's customer minutes of interruption divided by total customers within that sample, so if you are talking about an entire company, say, for example, CEI, it would be the customers would be around 730,000 I think is our customer count.

Q. I think you are even trying to think too hard.

SAIDI represents the average interruption that a customer would experience in the year average amount of interruptions that a customer would have experienced in a year; is that not correct?

A. It's the duration.

Q. The duration?

A. The duration, yes.

Q. And SAIFI representation the average number of interruptions customers would have experienced?

A. Right, the frequency.

Q. And CAIDI represents the --

A. The average interruption duration for the customers that have had outages.

Q. Yes. Thank you, I wanted to make sure we had something in the record to explain all of our acronyms.

A. Okay.

EXAMINER PRICE: Thank you. Redirect.

MS. MILLER: Can I have a couple of minutes, your Honor?

EXAMINER PRICE: You sure may.

(Recess taken.)

EXAMINER PRICE: Let's go back on the record.

Ms. Miller.

MS. MILLER: I do have two questions.

\- - -

REDIRECT EXAMINATION

By Ms. Miller:

Q. Mr. Schneider, there was some discussion regarding parts of the DSI rider having an incentive mechanism or incentive and whether the DSI writer in whole was an incentive.

Could you clarify your response?

A. Yes. Clearly in my testimony there was an area that specifically talks about incentives, that being the performance bands, but if you look at it from a holistic perspective, there is a revenue associated with DSI and, of course, part of the overall plan includes the commitments to spend a billion dollars and do all the other things we need to do to continue to ensure reliability for the system.

So from a holistic perspective you could look at it as incentive based -- you know, in its totality.

Q. And you were asked about capital spending and in previous years and how it compared to capital spending going forward or as the company's proposed in the plan. Can you clarify your answer?

A. Yeah. I think the question I was asked was how does the billion dollars commitment compare to what you've actually spent in the last two to three years.

And although I can't remember exactly what our spending was in those previous, say, three years, a billion dollars would probably represent something on the order of close to twice as much as we spent over the last two to three years.

MS. MILLER: No further questions, your Honor.

EXAMINER PRICE: Mr. Reese?

MR. REESE: No questions.

EXAMINER PRICE: Mr. White.

MR. WHITE: No questions.

EXAMINER PRICE: Ms. Wung.

MS. WUNG: No questions.

EXAMINER PRICE: Ms. McAlister.

MS. McALISTER: No questions.

EXAMINER PRICE: Mr. Smith.

MR. SMITH: No questions.

EXAMINER PRICE: Mr. Breitschwerdt.

MR. BREITSCHWERDT: No questions.

EXAMINER PRICE: Mr. Dunn.

MR. DUNN: No questions.

EXAMINER PRICE: Mr. Lavanga.

MR. LAVANGA: No questions.

EXAMINER PRICE: Mr. Bell.

MR. BELL: I am not going to let you down.

- - -

RECROSS-EXAMINATION

By Mr. Bell:

Q. And that increment can be associated with serving new load or moving load having no impact upon the reliability of all of your existing customers today, correct?

A. No, I don't think that's correct. I think if you looked at what our load growth was in the previous two or three years compared to what we would anticipate our load growth to be at least in the next two to three years, significantly reduced.

Just because of everything going on in

the economy, the housing coupled with the burst and that sort of thing.

MR. BELL: Thank you. That's all.

EXAMINER PRICE: Mr. Dunn.

MR. DUNN: No questions, sir.

EXAMINER PRICE: Mr. Wright.

MR. WRIGHT: One question.

- - -

RECROSS-EXAMINATION

By Mr. Wright:

Q. Again, having to do with SAIDI. Why has the company chose to build its incentive mechanism around SAIDI as opposed to SAIFI or CAIDI?

A. I think that SAIDI drives you to look at both CAIDI and SAIFI, obviously, because I think earlier it was stated that it's really a mathematical equation.

There are things if you just look at SAIFI, there are things you could do to improve SAIFI that don't necessarily help CAIDI and vice versa. I think SAIDI would represent us having to balance those things off.

MR. WRIGHT: Thank you.

EXAMINER PRICE: I have one final question and you can go home. Just a follow-up on my colleagues's question.

You have a broad waiver language that we have discussed about the broad waiver language in the Application Rule 10 has consequences for the company that can be proposed by the staff or by the Commission if the company fails to reach any performance targets.

And I just wanted to clarify that the broad waiver language does not apply to any action to be taken or proposed by the Commission or its staff under Rule 10 in the event that your SAIDI performance was north of 120 but below the 135?

THE WITNESS: That's correct.

EXAMINER PRICE: You're excused.

Ms. Miller.

MS. MILLER: Your Honor, at this time the companies wish to move into evidence Company Exhibit 3.

EXAMINER PRICE: Any objections?

Hearing none, 3 will be admitted.

(EXHIBIT ADMITTED INTO EVIDENCE.)

EXAMINER PRICE: See you all tomorrow morning. We are off the record.

(The hearing was adjourned at 6:50 p.m.)

- - -

CERTIFICATE

I do hereby certify that the foregoing is a true and correct transcript of the proceedings taken by me in this matter on Monday, October 20, 2008, and carefully compared with my original stenographic notes.

____
Karen Sue Gibson, Registered
Merit Reporter.

(KSG-5000)

- - -