

FILE

08-197-EL-SSO/08-918-EL-SSO J. Craig Baker

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10/25/2008

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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of)
Columbus Southern Power Company for)
Approval of its Electric Security) Case No. 08-917-EL-SSO
Plan; an Amendment to its Corporate)
Separation Plan; and the Sale or)
Transfer of Certain Generation)
Assets.)

In the Matter of the Application)
of Ohio Power Company for Approval) Case No. 08-918-EL-SSO
of its Electric Security Plan; and)
an Amendment to its Corporate)
Separation Plan.)

DEPOSITION

OF

J. CRAIG BAKER

Taken in the above styled matter pursuant to
Notice on the 25th day of October, 2008, commencing at
approximately 7:40 a.m. CDT at the location of The Village
of Baytowne Wharf at Sandestin, Baytowne Conference Center,
2nd Floor, Cypress Boardroom, Destin, Florida.

Reported by:

SHARON M. McALLISTER, Court Reporter

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1 APPEARANCES

2 JACQUELINE LAKE ROBERTS, Assistant Consumer's
3 Counsel and LEE SMITH, Consultant Ohio Consumers'
4 Counsel, and DANIEL DUANN, Analytic Consultant, 10 West
5 Broad Street, 18th Floor, Columbus, Ohio 43215-3485;
6 appeared on the behalf of the Ohio Consumers' Counsel.

7 HOWARD PETRICOFF, Attorney at Law, Vorys,
8 Sater, Seymour And Pease, LLP, 52 East Gay S., P. O. Box
9 1008, Columbus, Ohio 43216-1008; appeared on the behalf of
10 the Competitive Suppliers.

11 MARVIN RESNIK, AEP Service Corp., 1 Riverside
12 Plaza, 29th Floor, Columbus, Ohio 43215.

13 EMILY MEDINE, Energy Ventures Analysis.

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1 DEPOSITION

2 THEREUPON,

3 J. CRAIG BAKER, was called as a witness,
4 having been duly sworn to tell the truth, the whole truth
5 and nothing but the truth, was examined and testified as
6 follows:

7 DIRECT EXAMINATION

8 BY HON. ROBERTS:

9 Q. This is Jackie Roberts. Mr. Baker, I know
10 that you're experienced in depositions and so I'm not going
11 to go through the formal introduction.

12 Let me... let me say that if there's a
13 question you don't understand or you need me to repeat,
14 please let me know. I'm sure that if your Attorney has any
15 objections to questions that I ask you, he will object,
16 otherwise please go ahead and answer the question.

17 THE WITNESS:

18 A. I understand.

19 Q. Do you have your testimony with you,---

20 A. I do.

21 Q. ---Mr. Baker?

22 A. I do.

23 Q. All right. Let's... I'd like to first
24 address in your testimony the price to compare; and that
25 begins on about page 4, I believe.

1 (PAUSE- WHILE WITNESS REVIEWS DOCUMENT)

2 A. All right.

3 Q. You proposed blending the ESP with the market
4 price for the three years of the ESP Plan; is that correct?

5 (PAUSE)

6 A. I guess I'm... I... I have... I hate to do
7 this on the first question, but I'm not sure I understand
8 the question.

9 The ESP is a Plan that includes various
10 components that add up to a rate. We then compare that in
11 this section to what we believe the rate would be under the
12 Market-Rate Option, and out of that we come up with a
13 comparator to show the ESP is in the aggregate more
14 favorable.

15 Q. Well, let's turn to page 17 of your
16 testimony.

17 A. Okay.

18 (PAUSE- WHILE WITNESS REVIEWS DOCUMENT)

19 Q. It says on page 17, that the comparison
20 between the MRO and the ESP would be different, and in your
21 testimony you reflected a percentage blend.

22 A. Could you---

23 Q. And, it has House Bill 562.

24 A. You're going to need... can you point me to
25 a specific section where we talk about a blend?

1 Q. On page... in your testimony on page 17.

2 A. I am looking at page 17. I'm not sure we
3 have the same pagination, so if you would give me...

4 Q. All right. Hold on.

5 A. Uh huh (yes).

6 (PAUSE)

7 Q. I'm sorry, I didn't organize my notes that
8 way, so...

9 (PAUSE)

10 Q. I have to locate that in the testimony, in
11 your testimony.

12 (PAUSE)

13 Q. Well, I see... will you turn to page 5.

14 (PAUSE- WHILE WITNESS REVIEWS DOCUMENT)

15 Q. If you see the question on line 10, it
16 continues the discussion of including percentages of market
17 price in the ESP for comparison purposes.

18 (PAUSE- WHILE WITNESS REVIEWS DOCUMENT)

19 A. Are you... you're looking at the "Q. and A."
20 that starts on line 10 for purposes of the---

21 Q. Yes.

22 A. ---comparison?

23 Q. Yes.

24 A. This is the... when I talked a couple of
25 minutes ago, this is about how one determines what the price

1 would be under an MRO; and under an MRO as a company that
2 has not separated its generation, we are restricted by how
3 much if we did an MRO we could bring in in any given year.

4 Based on our understanding of the Bill and
5 the Revision of the Bill we chose ten, twenty and thirty
6 percent blends in the Market-Rate Option---

7 Q. Uh huh (yes).

8 A. ---not in the ESP.

9 Q. All right. And, in the ESP do you include
10 purchase power adjustment of five, ten and fifteen percent?

11 A. In the ESP we do propose to purchase five
12 percent of the load for Ohio Power and five percent for
13 Columbus Southern in the first year; ten percent in the
14 second year and fifteen percent in the third year.

15 Q. What do you mean by "slice-of-system"
16 regarding the purpose power; and I would say on page 21 of
17 your testimony, but I guess we don't know that that's
18 accurate.

19 So, let me just ask. Let me just talk about
20 "slice-of-system" regarding purchase power; what exactly do
21 you mean?

22 A. What we mean by that is that it would... the
23 amount of energy that we would be purchasing in the market
24 would match the load in any given hour relative to the peak
25 load for that year. So, it would not be a flat block of

1 power, for example, buying 100 megawatts per hour for every
2 hour of the year, but it would effectively be load shaped.

3 Q. It would be load shaped on the peak?

4 A. Against the peak; correct.

5 Q. And, that would be probably the most
6 expensive purchase power available during the year; would
7 you agree?

8 A. No, no, no, I think we're... we're not...
9 we're... I'm confusing you or we're not connecting here.
10 This would be purchasing power every hour, it would just be
11 the load in that hour relative to the peak load. So, we
12 would not only be purchasing at the peak time, but we
13 would---

14 Q. Oh, okay---

15 A. ---vary our energy take based on the load on
16 the system at any given hour.

17 Q. All right. When this purchase power is
18 acquired will it be through competitive solicitation?

19 A. I would expect that that would be the way we
20 do it, yes.

21 Q. And, what kind of competitive solicitation do
22 you envision?

23 A. I would assume that we would go out and put
24 out an RFP for those kinds of percentages, send it to all
25 interested parties and then review what we received back.

1 Q. And, what do you expect the terms of the RFP
2 to include?

3 A. The terms would be... there would be a lot
4 of terms. Obviously when you write a Contract you have to
5 deal with things like credit, failure to supply, but the
6 main factor would be that we would be looking for, as
7 described, a slice-of-system purchase from one or more
8 parties to match five percent of the load of Ohio Power and
9 Columbus Southern in year one, ten in year two, for each of
10 those companies and fifteen in year three.

11 Q. And, would it be deliverable to a certain
12 point?

13 (PAUSE)

14 Q. Who would it be delivered to, as a term of
15 the Contract?

16 A. It would be delivered to Ohio Power... or
17 AEP Ohio.

18 Q. And, would the seller be responsible for the
19 cost of delivering to AEP Ohio?

20 A. Yes.

21 Q. And, would the seller be responsible for the
22 risks of whether the power was used or would it be a taper
23 paycheck situation?

24 (PAUSE)

25 A. It would be used because we would be buying a

1 percentage of the load in every hour based on the... the...
2 based on that load in that hour, so...

3 Q. So, that would be scheduled as part of the
4 base load, I guess?

5 A. It would be scheduled.

6 Q. Okay. Could you acquire this power directly
7 from the Stock Market in PJM?

8 (PAUSE)

9 A. Yes.

10 Q. And, why have you not proposed that?

11 (PAUSE)

12 A. We just felt that a solicitation to a number
13 of competitors would provide a known value for people to
14 understand---

15 Q. But, you---

16 A. ---what their price would be for the full
17 three years.

18 Q. Could the power be acquired from the AEP
19 Pool?

20 A. No.

21 Q. And, why is that?

22 A. The AEP Pool does not have provisions for
23 solicitation of purchase power from the Pool by a Member
24 Company.

25 Q. So, your... the power you have... that

1 you're entitled to through the AEP Pool is just... it's
2 just that and not something that you would then turn around
3 and try to buy through solicitation?

4 I didn't say that very artfully, but do you
5 understand what I'm saying?

6 A. No, I'm not sure I do. This is... this is a
7 Purchase Power Agreement on behalf of AEP Ohio to serve a
8 share of its load. The Pool Agreement does not provide for
9 Member Companies to solicit from the Pool purchases of
10 capacity and energy as we are looking at here.

11 Q. All right. And, the Company's current supply
12 to meet the AEP Ohio load presently, will that be offset by
13 the five, ten and fifteen percent Contract for Purchase
14 Power?

15 In other words, will that reduce the amount
16 of power you're currently taking?

17 Like would it be through the Pool?

18 (PAUSE)

19 A. It... it will be a resource that AEP Ohio,
20 actually the two Companies individually, Columbus Southern
21 and Ohio Power will bring to the Pool as a supply option and
22 it will be dealt with on an hour by hour basis based on the
23 various supplies that each of the Member Companies bring to
24 the table as well as the load that they bring to the table.

25 Q. And, I guess what I'm trying to understand is

1 whether these purchase power of five, ten, and fifteen
2 percent increments would displace power that you would
3 ordinarily use and that you have a right to use?

4 A. And, I think you have to look at that on an
5 hour by hour basis---

6 Q. Uh huh (yes).

7 A. In some... and some cases a Company may be
8 purchasing and some situations a Company may be selling; so
9 I don't know how I just give you a blanket answer to that
10 question. It depends on the characteristics of the five
11 companies in any hour, as I said before, relative to their
12 generation and load profiles.

13 Q. But, for AEP Ohio, these increments of five,
14 ten and fifteen percent would displace power you would
15 otherwise use to provide the load in... in... for HUD
16 customers?

17 A. It---

18 Q. Is that an accurate statement?

19 A. It would be a source that would be used by
20 those Companies to serve its load and therefore would be
21 included in the amount of generation that is assigned to
22 those Member Companies.

23 Q. And, would this be a more expensive source of
24 power than would otherwise be used to serve Ohio customers?

25 A. We won't know that until we... we

1 ultimately run the RFP, but based on the numbers that we
2 have used for comparative purposes I would expect that if
3 those... if our estimates are right it would be a higher
4 cost than each of those companies' total supply cost.

5 Q. Okay.

6 A. That's it.

7 Q. And, do you have an order of magnitude of
8 that?

9 A. No, I don't.

10 Q. Okay.

11 (PAUSE)

12 Q. I'd like to talk about Black-Scholes, and I
13 believe that in your testimony beginning around page 26,
14 we'll see if we still have a pagination problem.

15 (PAUSE- WHILE WITNESS REVIEWS DOCUMENT)

16 Q. I think the Provider of Last Resort Charge
17 says on page 25 of the copy of your testimony that I have---

18 A. I have it on page 25, line 14.

19 Q. Okay. Good.

20 A. So, we may have the same pagination.

21 Q. All right. Just beginning with the need for
22 a POLR charge first.

23 On page 26 you discuss the precarious
24 position of the Company when you need to serve loads when
25 the market price is high?

1 (PAUSE- WHILE WITNESS REVIEWS DOCUMENT)

2

3 HON. RESNIK: This is---

4

5 BY HON. ROBERTS:

6 Q. And, it looks like that---

7

8 HON. RESNIK: Excuse me, Jackie. This
9 is Mr. Marvin Resnik, could you provide
10 a line reference--

11 HON. ROBERTS: I'm trying.

12 HON. RESNIK: ---in addition to the page
13 reference?

14 HON. ROBERTS: Unfortunately I didn't
15 take my notes that way, so...

16 HON. RESNIK: Oh, okay.

17 HON. ROBERTS: Um...

18 (PAUSE)

19 MRS. SMITH: It's line 7.

20 HON. ROBERTS: Line 7. It's line 7.

21

22 (PAUSE- WHILE WITNESS REVIEWS DOCUMENT)

23 BY HON. ROBERTS:

24 Q. Do you see that, Mr. Baker?

25 THE WITNESS:

1 A. Yes.

2 Q. Okay.

3 (PAUSE)

4 Q. As a Government Aggregator or a Government
5 Aggregation did not pay for stand-by service would we be
6 required to pay the market price of power for two years?

7 A. The... I think we cover... I covered that
8 in the testimony. We...

9 (PAUSE)

10 A. It is my understanding of Senate Bill 221,
11 that that provision could be provided for by the Commission.
12 What we... what I do indicate is a risk as we see it that
13 if the... if the price goes up, suppliers can't supply, the
14 Commission may not provide for selling... for us receiving
15 market rates for supplying that service, but instead take
16 these customers back at tariff and we have some experiences
17 as outlined in the testimony where that was the case.

18 Q. And, so are you assuming that that would be
19 determined in the Final Order in this case?

20 Or are you assuming that would be a risk that
21 could occur after there was a Final Order in this case?

22 A. Potentially both.

23 Q. Potentially both.

24 (PAUSE)

25 Q. What percentage of your distribution load is

1 currently served through municipal aggregation?

2 (PAUSE)

3 A. I don't know of any.

4 Q. You don't know of any?

5 And, other government aggregations?

6 A. I don't know of any.

7 (PAUSE)

8 Q. Would a... would an aggregator...

9 (PAUSE)

10 Q. I'm trying to understand the nature of this
11 problem. Since you... since you have... currently you're
12 not aware of any aggregation, does this, that you discussed
13 could be a problem only have market prices drop for the
14 municipality aggregated and then... then the price... then
15 the market price is increased and it came back for service.

16 That's what you discussed, or described,
17 isn't it?

18 (PAUSE)

19 Q. They come back at a higher price?

20 A. The sentences we are talking about that is
21 the case. That is not the total risk of POLR.

22 Q. No, you... but, is that the total shopping
23 risk that you have addressed?

24 You've addressed other risks, but this is the
25 basic risk of return of aggregated customers, is it not?

1 A. If you are talking only about the return
2 component, that is a risk that we have identified in the
3 reason to have this charge. We've also indicated that this
4 is a series of options that are provided for in this Bill
5 for customers where we are in the position of having to
6 supply power to customers at below market rates when our
7 tariff rates are lower, and then customers can leave us at
8 any time it becomes economically advantageous.

9 And, then they can, in our view, come back to
10 tariff any time it becomes economically advantageous to go
11 the other way. So, there is a series of options built in
12 and that is what we are trying to address with the POLR
13 charge.

14 Q. If you were to meet the returning load by
15 purchasing through the market, wouldn't those purchases be
16 passed through to the Fuel Adjustment Clause?

17 (PAUSE)

18 A. It could be if the Commission approved it.

19 Q. And, you... would you agree that if the
20 Commission allowed those costs to be included in the Fuel
21 Adjustment Clause that the Company would be made whole with
22 regard to those higher power costs?

23 (PAUSE)

24 A. If the Commission authorized us for the full
25 period of the ESP, that if a customer returned after leaving

1 us, that we would be able to go out and buy that power in
2 the market and run it through the Fuel Clause. We would
3 have protection against one of the risks that leads to the
4 POLR charge.

5 Q. And, that risk would be that you would have
6 to buy high and sell low?

7 A. No, the... that's the potential buy high
8 part of it.

9 (PAUSE)

10 Q. If there's no load increment or detriment
11 between 2009 and 2011 caused by customers returning from
12 other suppliers or leaving other suppliers, will the Company
13 simply keep the dollars that its collected through the POLR
14 charge?

15 (PAUSE)

16 A. I... can you re-state that question or can I
17 have it re-read? I'm not sure I understand it.

18 Q. Assuming there's no load increment or
19 detriment between 2009 and 2011 caused by customers
20 returning from other suppliers, will the Company keep the
21 dollars that its collected for the POLR charge?

22 A. The POLR charge is a charge that exists
23 because customers have the options that I have outlined. It
24 does not... the POLR charge, as its designed, does not
25 change as customers come and go.

1 Q. So, is that "yes"?

2 (PAUSE)

3

4 HON. RESNIK: I'll object to that. The
5 witness has answered.

6

7 BY HON. ROBERTS:

8 Q. Well, I'm just trying to understand whether
9 the Company is collecting a POLR charge and keeping the POLR
10 charge regardless of whether customers come and go?

11 (PAUSE)

12 THE WITNESS:

13 A. And, I believe my answer addressed that.

14 Q. Could you repeat that for me, please?

15 A. What I said was that the POLR... the way we
16 have designed this, POLR... the POLR charge is a charge to
17 customers for the period of the ESP and stays the same
18 regardless of whether there is customer shopping, some
19 customer shopping, a lot of customer shopping, if...

20 The POLR charge is to compensate for the
21 risks associated with those factors.

22 Q. And, there's no provision in the Plan to ever
23 refund any of that POLR charge under any circumstance, is
24 there?

25 A. No, there is not a plan to refund POLR

1 charges.

2 Q. Okay.

3 (PAUSE)

4 Q. And, in your testimony you've calculated the
5 POLR charge using the Black-Scholes methodology?

6 A. That is the option modeling that we used to
7 value the POLR and to create a price for the POLR service.

8 Q. And, after valuing the POLR service and the
9 price were you able to quantify the cost for each Company by
10 year resulting from the POLR charge?

11 A. What we have... what we have determined is,
12 based on the inputs to the model, we have come up with a
13 value of those options for each year.

14 Q. And, is it correct to say that for CSP the
15 POLR revenue requirement would be \$108.2 million per year?

16 I'm sorry... yes. And, for OPC it would be
17 \$60.9 million?

18 And, I'm referring to your testimony page 34,
19 line 21.

20 (PAUSE- WHILE WITNESS REVIEWS DOCUMENT)

21 A. That is what the testimony says on line 21.

22 Q. So, over the course of the Plan the Company
23 would recover revenues for the POLR requirements of about a
24 half a billion dollars; is that fair?

25 A. That would be the sum of those revenue

1 requirements if you assumed that the load, as used in our
2 analysis, is the actual load.

3 Q. And, if the load is... is... the... if the
4 load changes, can you tell me how that would affect what the
5 POLR revenue requirements would be?

6 A. Well, this is determined on an estimate...
7 on our estimate of what we project load to be in those
8 years. Now, this is load on the wires, not load that we
9 necessarily serve with our own generation.

10 So, if the load that we have on our wires,
11 we're required to stand ready for were higher in those two
12 Companies, then... then that value would go up. If in fact
13 the load that we're required to stand ready to serve goes
14 down, those numbers would go down.

15 Q. And, how often would that load differential
16 be calculated?

17 A. It would just be... that's... that's part
18 of the price the customer has paid and it would just be
19 effectively automatic. The... if the load went down there
20 would be less megawatt hours that we would be assigning this
21 to. If the load went up---

22 Q. Oh, I see.

23 A. ---there would be more megawatt hours---

24 Q. I see.

25 A. ---we would assign it to.

1 Q. I see, all right. All right.

2 (PAUSE)

3 Q. Do you recall that you responded to
4 Interrogatories of the Ohio Consumer Counsel regarding the
5 POLR charge?

6 A. Yes, I do, but I do not have them with me.

7 (PAUSE)

8 Q. You were asked... I can just read it to you.

9 A. Okay.

10 Q. Because its short in most cases. You were
11 asked;

12 "How many scenarios related to the POLR
13 were evaluated by the Company with
14 Black-Scholes?"

15 And, you responded;

16 "In preparation of the Company's ESP
17 files the Black-Scholes model would run
18 an indeterminate number of times.
19 However, the methodology itself, i.e.
20 the Black-Scholes model, was not
21 modified."

22 So, in running the Black-Scholes an
23 indeterminate number of times what variables were you
24 changing in the runs?

25 (PAUSE)

1 A. The---

2 Q. Or why were you... why did you run it an
3 indeterminate number of times?

4 Let's start there.

5 A. Sure. Sure. Um...

6 (PAUSE)

7 A. This was the first time we have used this
8 approach as a methodology to value POLR. Therefore, when
9 you're working with a model that's been around quite a few
10 years, one... and it has inputs that are described in the
11 testimony one has to try to determine what inputs... or
12 what... what those... how do you define those inputs for
13 use in the model.

14 And, let me just give you one example. We
15 talked here about... as we did it we took the prices for
16 the first week in each quarter of three quarters, and that
17 was a methodology to try to levelize the impacts and not
18 have a period where prices were low in the market or prices
19 were high in the market.

20 We looked at pricing it just on one day.
21 Then we looked at pricing it based on multiple days. So,
22 we... we did different scenarios, as you called them, in
23 order to try to find something that we found was most
24 representative.

25 As we did this interest rates may have

1 changed, so every... we didn't run this one time, we ran it
2 a number of times, settled on the inputs and then using the
3 same methodology used the inputs described in the testimony
4 for purposes of making a determination.

5 Q. Now that there's data available for the first
6 week of the quarter following, the numbers you used in the
7 Black-Scholes model, since you want the most representative
8 data, would it be appropriate to update and run that model
9 again using the current data?

10 (PAUSE)

11 A. I don't know what the impact would be. I
12 don't know whether that would cause the POLR revenue
13 requirement to go up or down. I think you have to draw a
14 time and say, this is where we think the... or where the
15 price is and the interest rates are representative. I don't
16 think you can keep changing it.

17 Q. Do you think the prices or the interest rates
18 from the first week in the second and third quarters are
19 representative of the prices and interest rates today?

20 A. I have not done that analysis to determine
21 that.

22 Q. If you thought the prices... if you were to
23 learn that the prices and the interest rates today were much
24 different than those that you included in your run of the
25 Black-Scholes model do you believe it would be appropriate

1 to re-run the model?

2 A. Not necessarily.

3 (PAUSE)

4 Q. Didn't you say that you wanted the most
5 representative prices?

6 The most representative data in running the
7 models?

8 A. Yes.

9 Q. So, why would you make a determination that
10 the most current data or data showing a change in the market
11 wouldn't be representative?

12 A. Because what we would have to do is determine
13 whether the values in that fourth quarter, as I think you're
14 describing it, are representative of what the values would
15 be for the period 2009 through 2011. We have not done that
16 analysis.

17 Q. You are generally aware that market prices
18 are down and interest rates are down; is that correct?

19 A. As I had indicated, I have not done an
20 analysis that compares either the market prices or the
21 interest rates with... for the fourth... for the fourth
22 period as you've described it with the other three, so I
23 can't tell you that I know that... what the impacts are.

24 Q. Let me ask you that again.

25 Compared to the data that you used from last

1 Summer, are you generally aware that market prices and
2 interest rates have declined?

3 A. I believe that I had answered that. I have
4 not gone back and studied the three periods that we used and
5 compared them to the like period in the fourth period as you
6 described. I haven't looked at it, so I can't generally
7 make a presumption without having looked at the data.

8 Q. All right. And, you have no general
9 knowledge of how interest rates have changed over the last
10 three months?

11 (PAUSE)

12 A. I have a general knowledge of interest rates
13 in the last three months, but I haven't done a comparison to
14 what it looked like for the three periods.

15 Q. I understand. I understand you haven't done
16 the analysis.

17 (PAUSE)

18 Q. How as it that you decided to use the Black-
19 Scholes model?

20 A. I worked with our Commercial Operations Team
21 and we came up with that as a generally accepted methodology
22 for pricing the value of options.

23 (PAUSE)

24 Q. And, when you used the Black-Scholes model
25 did you calculate it in-house or did you have to purchase

1 software that calculated it?

2 A. We ran it in-house.

3 Q. Okay.

4 (PAUSE)

5 Q. And, do you know what kind of options Black-
6 Scholes was developed to be used for?

7 (PAUSE)

8 Q. Was it... was it power price options?

9 A. I don't... I don't know what the first
10 person who developed Black-Scholes used as their data for
11 determining it. I just know that it is a commonly accepted
12 practice in the financial industry to price the value of
13 options.

14 Q. Is it kind of... is it... would you say
15 that its commonly accepted in the utility industry to price
16 energy options?

17 A. Yes.

18 Q. And, who do you know that uses the Black-
19 Scholes model for that purpose?

20 A. I would assume that most anyone who is
21 pricing options around electric energy uses that as one of
22 their ways to determine how they set the price for an option
23 or what they're willing to pay for the option.

24 Q. I think I asked you if you knew what other
25 utilities used the Black-Scholes model, not what you assumed

1 about that.

2 Do you know other utilities have employed the
3 Black-Scholes model?

4 A. I have not done a survey to find out which
5 utilities use Black-Scholes to price options for electric
6 energy. I have not done that, but I know that we used it
7 and from my understanding in talking to people in our
8 Commercial Operations Group, that they believe that others
9 use it as well.

10 Q. So, what do you... what do you base your
11 statement on that you think it's commonly or generally
12 accepted for the uses that you have... the uses you've
13 employed it for in your testimony?

14 (PAUSE)

15 A. It's... its something that, as I say, is an
16 accepted standard in the financial industry. And, it is the
17 way... one of the ways that people price options. So, I
18 don't know that I can say a whole lot more than that.

19 (PAUSE)

20 Q. All right.

21 (PAUSE)

22 Q. Are there other ways you could have accounted
23 for the costs of any potential returning shopping customers?

24 A. Again, let's... let's be clear that I
25 indicated that that... that the POLR charge is not just for

1 the return of customers, its for the fact that customers
2 have a series of options to come and go to tariff rates.

3 So, it is a... it is not only if they leave
4 and come back, but its standing... having the obligation to
5 sell at tariff to them when the prices in the market are
6 high and the converse when prices are low. Um...

7 (PAUSE)

8 Q. Are there other ways to meet that obligation?

9 A. Yeah, there are... we could... we could
10 look at the price of capacity that the Company has on its
11 own books. You could look at the price of capacity in the
12 PJM market, there are other ways you could do it.

13 Q. Did you look at those methods?

14 A. Yes.

15 Q. And, what were the results of that analysis?

16 A. I did... I have looked at it on the back of
17 the envelop type of calculation and in each of those cases
18 the price would be higher.

19 Q. Did you look at forward prices as a way to
20 hedge against these risks?

21 A. As I said, I looked at the price of capacity
22 in the PJM market looking forward as another way to price
23 the POLR charge.

24 (PAUSE)

25 Q. Is the Black-Scholes used by any other areas

1 of AEP to... for any purposes?

2 (PAUSE)

3 A. I believe you have an Interrogatory that
4 answered that question. Um... and... and we did indicate
5 that we use it in valuing options and I don't remember the
6 other areas that we pointed out.

7 Q. Oh, are you referring to the Interrogatory
8 that says... "If you indicate the Black-Scholes is not used
9 in any other applications, why not?"

10 Is it only used in the Commercial Division?

11 A. I...

12 (PAUSE)

13 A. Again, I... I believe we use it in other
14 financial situations as well as the Commercial Operations.

15 (PAUSE)

16 Q. But, you wanted it for the Commercial
17 Operations; is that correct?

18 A. That's who I worked with on developing a
19 charge for POLR.

20 Q. All right.

21 (PAUSE)

22 Q. With respect to the Ormet Agreement; didn't
23 Columbus Southern Power agree to the return of Ormet into
24 their service territory?

25 (PAUSE)

1 Q. As opposed to being ordered to incorporate
2 Ormet into their service territory?

3 A. We jointly filed with the Commission for that
4 change after a Complaint was filed by Ormet.

5 Q. In working with the Black-Scholes model do
6 you know whether the model is very sensitive to input and
7 assumptions?

8 (PAUSE)

9 A. I...

10 (PAUSE)

11 A. The... the outcome of the model is based on
12 the assumptions that go into it. I don't know how to define
13 "very sensitive", that's incredibly a subjective question.
14 You put in inputs that are representative of what you
15 believe... or what are the future price of power, the cost
16 of the strike price, the term, et cetera and you get an
17 outcome.

18 If you dramatically change the inputs it will
19 dramatically change the outcomes.

20 Q. And, with Black-Scholes, if you don't
21 dramatically change the inputs can it dramatically change
22 the outcome?

23 A. The---

24 Q. That's what I am trying to determine by
25 asking if it's a sensitive model?

1 (PAUSE)

2 A. Well, I... its driven by the inputs.

3 Q. And, is it sensitive to the inputs?

4 (PAUSE)

5 Q. Do you understand that concept?

6 Maybe I'm not being clear.

7 A. No, I'm not understanding where you're coming
8 from.

9 (PAUSE)

10 Q. All models have inputs and outputs?

11 A. Correct.

12 Q. And some models are more sensitive to inputs
13 and assumptions as it affects what the output is.

14 Do you know whether that's the case for
15 Black-Scholes?

16 (PAUSE)

17 A. Um... and I... I need more information. I
18 don't understand what models are not sensitive to the inputs
19 you give them. That's the whole concept of a model in my
20 view, is the inputs will produce an output based on the way
21 the model runs, so they're all sensitive.

22 Q. All right.

23 (PAUSE)

24 Q. Is it fair to say that you used Benchmark
25 prices to establish the market price for the Black-Scholes

1 model?

2 A. Could I have that read back, please?

3

4 COURT REPORTER:

5 (AT THIS POINT IN TIME READ BACK THE PREVIOUS
6 QUESTION AS FOLLOWS:

7 "Q. Is it fair to say that you used the Benchmark
8 prices to establish the market price for the Black-Scholes
9 model?"

10

11 THE WITNESS:

12 A. Could you rephrase the question, please?

13 BY HON. ROBERTS:

14 Q. Yes. For the Black-Scholes model you said
15 you used representative market prices, they were the first
16 week of every quarter; is that correct?

17 THE WITNESS:

18 A. That's correct.

19 Q. And, for the strike price that you used, it
20 was the proposed ESP price?

21 A. It was the proposed ESP price for year one.

22 Q. For year one. And, would that change in year
23 two and three?

24 A. If we... if we included in the model the ESP
25 price for years two and three, as we have filed, the POLR

1 would go up.

2 Q. Okay.

3 (PAUSE)

4 Q. And, you decided not to do that why?

5 (PAUSE)

6 A. We are... it was a methodology that we chose
7 to be conservative in setting this charge, because it was
8 the first time we were putting a POLR charge in this way, so
9 what we did was attempt to make conservative choices into
10 the inputs to reduce the cost of the POLR charge to
11 customers.

12 Q. All right. Is it fair to say that the higher
13 the volatility the higher the option price will be using
14 Black-Scholes?

15 A. Yes.

16 Q. Okay. And, you estimate future volatility
17 from futures contracts; is that correct?

18

19 COURT REPORTER: For "future contracts", I'm
20 sorry.

21 THE WITNESS: I think she needs you to
22 rephrase the question.

23 COURT REPORTER: Did you say "future
24 volatility---

25 HON. ROBERTS: If you ask me---

1 COURT REPORTER: ---for future contracts"?

2

3 BY HON. ROBERTS:

4 Q. You estimate future volatility from the
5 futures contracts?

6

7 COURT REPORTER: Thank you.

8

9 BY HON. ROBERTS:

10 Q. Is that correct?

11 THE WITNESS:

12 A. Can you point me to a specific spot in my
13 testimony on this... on the volatility question?

14 Q. Um... well, I might be able to.

15 (PAUSE)

16 A. Yeah, it... I'm sorry, I can find it. It's
17 on page 32 and its under column 5, and yes, it's based on
18 the volatility of futures contracts.

19 Q. And, what period did you use for those
20 contracts?

21 A. For contracts for the term 2009 through 2011.

22 Q. And, what data source did you use to
23 determine the futures contracts prices?

24 (PAUSE)

25 A. For the volatility or for the market price?

1 Q. For the market price?

2 A. For the market price---

3 Q. Then I'm going to ask you about the
4 volatility.

5 A. I'm sorry?

6 Q. About the volatility, I'm sorry.

7 A. I don't remember, I'd have to go back and
8 look.

9 Q. Could you provide that to me?

10 (PAUSE)

11

12 HON. RESNIK: Well, why don't we wait
13 until the end of the deposition and see
14 what's outstanding.

15 HON. ROBERTS: Okay, fair enough.

16 HON. RESNIK: If you want to make a note
17 of that.

18 HON. ROBERTS: Okay.

19

20 BY HON. ROBERTS:

21 Q. If you used only 2009 futures do you know
22 what the results would have been?

23 THE WITNESS:

24 A. No.

25 Q. Did you make that calculation?

1 A. No.

2 (PAUSE)

3 Q. Do you expect customer switching to increase
4 beyond what you currently experience, which is basically
5 none, I guess?

6 A. I don't know.

7 (PAUSE)

8 Q. All right. Let me move on. Um...

9 (PAUSE)

10 Q. One of your statements for justifying the
11 price to compare is a statement on page 21 of your testimony
12 regarding, "other companies in the AEP system that have
13 experienced recent rate activity"---

14

15 HON. RESNIK: Excuse me, Craig, before you
16 answer; what do you mean by "price to
17 compare"?

18 HON. ROBERTS: The MRO and the ESP.

19 HON. RESNIK: Okay. And, the reason I ask
20 is---

21 HON. ROBERTS: (Inaudible)

22 HON. RESNIK: ---that "price to compare" has
23 a very specific meaning that shows up on
24 Company bills for customers to look at.

25 HON. ROBERTS: Oh.

1 HON. RESNIK: To decide whether to switch or

2 not. So, "price to compare" is not---

3 HON. ROBERTS: No, I'm not referring to

4 that.

5 HON. RESNIK: ---a concept in dealing with

6 the MRO versus ESP comparison.

7 HON. ROBERTS: Yeah, I'm sorry. That's

8 what I'm talking about.

9

10 BY HON. ROBERTS:

11 Q. In your testimony comparing the MRO and the
12 ESP; on page 21 you testify that;

13 "other companies in the AEP system have
14 had recent rate activity and increases
15 in the range from twenty to thirty-four
16 percent."

17 THE WITNESS:

18 A. I see that statement.

19 Q. All right. In a response to an Interrogatory
20 you said that the companies were APCO Virginia, APCO West
21 Virginia, I&M Indiana, KPCO Kentucky and PSO Oklahoma.

22 Is that the universe of Companies that you're
23 talking about with respect to the statement?

24 A. Those were the Companies that I utilized in
25 coming up with the range of twenty to thirty-four percent.

1 Q. All right. And, you indicated the APCO West
2 Virginia had approved an increase of about twenty percent?

3 (PAUSE)

4 A. You're... you're looking---

5 Q. In your Response to OPC Interrogatory number
6 25..

7 A. I... I don't have that in front of me, I can
8 accept it subject to check.

9 Q. That would be great.

10 And, for KPCO Kentucky, the increase was
11 about thirty percent; would you accept that subject to
12 check?

13 A. Yes.

14 Q. And, for PSO Oklahoma the approval was about
15 twenty-five percent; do you accept that subject to check?

16 A. Yes.

17 Q. And, can you explain to me then how you have
18 a range of twenty to thirty-four percent for increases?

19 I only see indications of twenty to thirty
20 percent?

21 (PAUSE)

22 Q. Am I missing something.

23 A. Um...

24 (PAUSE)

25 A. I can't answer... I don't... I don't have

1 the data in front of me to answer that. Um... to get from
2 the range that you described, the twenty to thirty to
3 thirty-four, but I know that I had data to support that when
4 I developed---

5 Q. Okay.

6 A. ---the testimony.

7 Q. We'll talk about that at the end then.

8 For these cases that you identified, it's
9 your opinion that they're representative of recent rate
10 activities that would be appropriate to compare to AEP
11 Ohio's rate activity?

12 A. The... you have... this is looking at the
13 fact that we have put a limit in any year to approximately
14 fifteen percent increases to customers and comparing that to
15 rate activity in other States.

16 Q. And, I'm trying to understand the rate
17 activities that's going on in other States to make a
18 determination of whether that's an appropriate comparison.

19 So in, for example, APCO West Virginia, is
20 that a regulated State?

21 A. Yes.

22 Q. And, were there price caps or Rate
23 Stabilization Agreements in that State?

24 A. There were rate freezes over the last... at
25 some point in the last ten to fifteen years, but I don't

1 know what you're... what you're aiming at, relative to
2 when?

3 (PAUSE)

4 Q. So, there were price freezes in APCO West
5 Virginia, and do you... can you give me an idea of what
6 part of that twenty percent increase was a result of the
7 rate freezes being removed?

8 I assume they were removed?

9 A. I think you're making an assumption that I'm
10 not... that I didn't state, in that all I said was there
11 were rate freezes some time in the last ten to fifteen
12 years. I didn't state whether the increase that we looked
13 at in determining this range was a change that came from a
14 rate freeze or not.

15 Q. That's right.

16 And, for KPCO Kentucky?

17 (PAUSE)

18 A. They did---

19 Q. Was there a rate freeze in Kentucky?

20 A. No.

21 Q. And, what represented... what cost
22 represented the bulk of this rate increase?

23 A. I believe for Kentucky it was mostly fuel.

24 Q. And, when was the last fuel increase?

25 A. They have an annual fuel cost.

1 Q. And, for PSO Oklahoma, what's the bulk of the
2 cost that's represented their rate increase?

3 A. It was a combination of base rate and fuel.

4 Q. Did they have rate freezes?

5 A. No.

6 Q. And, do you know when the last time they
7 filed a rate case was before the one you're referring to?

8 A. No.

9 Q. Okay.

10 (PAUSE)

11 Q. I'm making a note to ask for that at the end.

12 (PAUSE)

13 Q. I'd like to look at your Exhibit #2 if we
14 could.

15 (PAUSE)

16 Q. And, I'm turning to that as well.

17 (PAUSE- WHILE WITNESS REVIEWS DOCUMENT)

18 Q. What does this Exhibit show us, Mr. Baker?

19 A. The is a Financial Analysis, which I believe
20 is only one of the pieces to estimating... to showing in
21 effect that in the aggregate the ESP is more beneficial to
22 customers than AEP Ohio implementing a Market Rate Option.

23 (PAUSE)

24 Q. Does it... does it show us the full cost of
25 power?

1 A. No, that's not what it was intended to do.

2 Q. And, how would that change the schedule if it
3 were to include the full cost of power?

4 (PAUSE)

5 A. The...

6 (PAUSE)

7 A. The Schedule would look very different. The
8 result I believe would still show that the estimated cost or
9 the ESP is better in the aggregate than the Market Rate
10 Option.

11 Q. In addition to the cost shown for the
12 "Estimated Cost of the Market Rate Option", a portion of the
13 MRO power and cost would be priced at some SSO rate, would
14 it not?

15 A. Yes, this was a... what we hoped to be a
16 relatively easy way to look at those impacts, because we
17 assumed that the rate... that a lot of the provisions under
18 the MRO, or what I termed the non-market rate... or the
19 non-market supply would have similar prices or virtually the
20 same prices as the ESP.

21 Q. And, specifically in 2009 another ninety
22 percent of the kilowatt hours needed will be included in the
23 POLR MRO cost; is that correct?

24 A. This... this...

25

1 HON. RESNIK: Could you repeat the question
2 please?

3 HON. ROBERTS: Would you re-read the
4 question?

5 _____

6 COURT REPORTER:

7 (AT THIS POINT IN TIME READ BACK THE PREVIOUS
8 QUESTION AS FOLLOWS:

9 "Q. And, specifically in 2009 another ninety
10 percent of the kilowatt hours needed will be involved---

11 HON. ROBERTS: Will be included.

12 "---will be included in the POLR MRO cost; is that
13 correct?"

14 _____

15 (PAUSE)

16 THE WITNESS:

17 A. The... if what you're saying is that under
18 an MRO, using the percentages that we have, that ten percent
19 would be priced at market rate and ninety percent would be
20 based on a rate that starts with our current rate and adjust
21 it for certain costs; the answer is yes.

22 BY HON. ROBERTS:

23 Q. And, are both of those costs included in this
24 schedule?

25 THE WITNESS:

1 A. No, this is an incremental analysis as a way
2 to make this showing. You could do it other ways, this was
3 the way that we felt was the most representative and the
4 easiest to understand.

5 Q. And, similarly would the ESP cost, that
6 solution at ninety-five percent; is that correct?

7

8 MRS. SMITH: Five percent?

9 HON. ROBERTS: Ninety-five percent.

10 MRS. SMITH: Five.

11 HON. ROBERTS: Five percent, I'm sorry.

12

13 THE WITNESS:

14 A. The cost of the ESP includes the fact that
15 the fact that the Company would be purchasing five, ten and
16 fifteen percent and adding that to its supply.

17 (PAUSE)

18 BY HON. ROBERTS:

19 Q. All right. And, do you assume that the non-
20 market portion of an MRO SSO will be priced on a per
21 megawatt hour basis identically to the non-market portion of
22 the ESP?

23 (PAUSE)

24 THE WITNESS:

25 A. I'm going to need that one read back?

1

2 COURT REPORTER:

3 (AT THIS POINT IN TIME READ BACK THE PREVIOUS
4 QUESTION AS FOLLOWS:

5 "Q. And, do you assume that the non-market
6 portion of an MRO SSO will be priced on a per megawatt hour
7 basis identically to the non-market portion of the ESP?"

8

9 (PAUSE)

10 THE WITNESS:

11 A. There's no non-market portion of the ESP,
12 that is a provision under the MRO.

13 BY HON. ROBERTS:

14 Q. Okay.

15 (PAUSE)

16 Q. You have proposed the recovering cost of the
17 POLR obligation. Let me ask... let me ask... the risk of
18 the POLR obligation.

19 Let me ask you, what actual cost does AEP
20 incur as a result of the POLR obligation?

21 (PAUSE)

22 A. It's... it's the cost associated with the
23 risk provided in the options that we've given... we provide
24 to customers.

25 Q. And, those aren't known at this time; is that

1 correct?

2 A. Those are... those are determined based on
3 the Black-Scholes model.

4 (PAUSE)

5 Q. All right. So, that's supposed to be...
6 isn't Black-Scholes a methodology for compensating the
7 Company for those risks?

8 A. For price---

9 Q. It's not the actual cost of those risks, is
10 it?

11 (PAUSE)

12 A. It is... it is the cost associated with
13 providing that optionality. Is it an out of pocket cost for
14 an option that we went out and exercised? And, the answer
15 is, yeah, we believe that that would be the price if we
16 exercised those kinds of options. We have not committed to
17 either making or not making those purchases of those
18 options.

19 Q. You had made a comment that the recovery of
20 purchase power costs would only cover a portion of the POLR
21 risks; do you recall that just a little earlier?

22 A. I don't think that's what I said. I believe
23 what I was saying was that the... if you were to be
24 permitted as a Company, that if a customer left and came
25 back, that you could then charge that customer market that

1 would cover part of the risks that we're trying to identify
2 in the POLR charge.

3 Q. And, can you tell me what other risks there
4 are?

5 A. Yeah, it's a series---

6 Q. ---as its identified in your testimony?

7 A. I'm sorry?

8 Q. Are the other risks the risks identified in
9 your testimony or are they some other risks?

10 A. It's the risk of customers being able to
11 leave the Company with the power that they otherwise are
12 obligated to deliver those customers when the prices in the
13 market goes low and the obligation to take those customers
14 back.

15 If the market price goes up and the customers
16 exercise what would be rational economic action to
17 effectively go to the market when prices are low and come to
18 the Company when the prices are high.

19 Q. And, those are the risks that you've
20 identified in your testimony?

21 A. Yes.

22 Q. I'm just trying to confirm that there aren't
23 other risks that you haven't identified in your pre-file
24 testimony.

25 A. That's what the POLR is intended to... the

1 risks that its looking at.

2 Q. All right. I have some questions about the
3 FAC. You said that the goal... on page 20 of your
4 testimony;

5 "The goal of the FAC phase-in is to
6 hold annual total rate increases to
7 fifteen percent for each rate
8 schedule".

9 Do you recall that?

10

11 HON. RESNIK: I'm sorry, what page did you
12 refer to?

13 HON. ROBERTS: Page 20.

14 HON. RESNIK: Thank you.

15 HON. ROBERTS: I hope our pagination is
16 matching.

17 HON. RESNIK: I'm sure that's fine.

18 (PAUSE)

19 HON. ROBERTS: And, I'm sorry I don't
20 have a line number for you.

21 HON. RESNIK: It's line 7.

22 HON. ROBERTS: I promise that when you're
23 on the stand I will have line numbers for
24 you.

25 HON. RESNIK: It's line 7, Craig.

1 THE WITNESS: Okay.

2

3 THE WITNESS:

4 A. I see the sentence that;
5 "The goal of the FAC phase-in is to
6 hold annual total rate increases to
7 approximately fifteen percent for each
8 rate schedule in the Companies'
9 tariffs."

10 BY HON. ROBERTS:

11 Q. Right. And, what do you mean by, "total
12 annual rate increase"?

13 (PAUSE)

14 THE WITNESS:

15 A. That's the change in total rates that a
16 customer pays.

17 Q. Are there any circumstances under the ESP
18 where the phase-in... where it was the phase-in... where
19 it was the phase-in total annual rates, including
20 Transmission could exceed fifteen percent?

21

22 HON. RESNIK: Excuse me, are you referring
23 to the bottom of page 20 now?

24 (PAUSE)

25 HON. ROBERTS: Yes.

1

2 THE WITNESS:

3 A. Well, there's two factors. One is we use the
4 term "approximately fifteen percent", and therefore in the
5 rate design in some cases it is fifteen and in some cases it
6 is below fifteen and some above, but its approximately
7 fifteen.

8 And, in addition to that there could be other
9 things... other costs that increase it more than fifteen
10 percent and those are identified at the bottom of page 20.

11 BY HON. ROBERTS:

12 Q. Does the maximum annual rate increase of
13 fifteen percent for each rate schedule mean that each rate
14 schedule will see the same annual total rate increase?

15

16 HON. RESNIK: Could you read the question
17 again, please?

18

19 BY HON. ROBERTS:

20 Q. Does the maximum annual rate increase of
21 fifteen percent for each rate schedule mean that the...
22 that each rate schedule will see the same annual total rate
23 increase?

24

25 HON. RESNIK: Okay. And, I'm going to object

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1 because it mischaracterizes the pre-file
2 testimony and the testimony that Mr. Baker
3 just gave. It's not a maximum. He explained
4 it, there's an approximation, some might be
5 higher, some might be lower.

7 BY HON. ROBERTS:

8 Q. Are there any rate schedules exceeding
9 fifteen percent annual increase in the filing?

10 THE WITNESS:

11 A. Yes, I believe there are.

12 Q. And, will other rate classes rates be raised
13 up to the fifteen percent before accruing any balance for
14 deferral?

15 A. The filing as a proposed set of rates that,
16 as we indicate here, hits approximately the fifteen percent
17 for each of the rate schedules. Those will be the basis of
18 determining the deferrals.

19 (PAUSE)

20 Q. You're familiar with Mr. Roush's testimony;
21 is that correct?

22 A. I... I have... I am familiar. I will tell
23 you that I have not read it in preparation for this
24 deposition.

25 Q. I understand and you may not have it with

1 you.

2 Do you have it with you?

3 A. I do not have it with me.

4 Q. Okay. Well, let's see if you recall this;

5 Mr. Roush has a table depicting the summary
6 of requested rate release increase... of requested rate
7 increases, which shows increases of fifteen percent in 2010
8 and 2011, but it doesn't show any increase in transmission
9 costs.

10 (PAUSE)

11 Q. Is that because the transmission costs are
12 collected separately through the Transmission Rider?

13 A. I don't know, I'd have to look at that
14 schedule.

15 Q. Okay. And, based on our discussion a few
16 minutes ago I think you would agree that the transmission
17 cost increases could cost a total cost increase to exceed
18 fifteen percent?

19 (PAUSE)

20 A. Yes, I think there's a potential that the
21 Transmission Cost Recovery Rider could be... make it higher
22 than fifteen percent or potentially lower than fifteen
23 percent.

24 Q. All right. Once the non-FAC or base portion
25 of the initial SSO has been established, do you then propose

1 that that's increased annually by three or seven percent,
2 depending upon the Company?

3 A. Yes.

4 Q. What was the basis for determining what these
5 increases would be?

6 (PAUSE)

7 A. The percentages that were chosen are
8 consistent with the percentages that were used to adjust
9 total rates in the RSP, so we believe customers are familiar
10 with that. And, we looked at it as a methodology that would
11 help us cover the inflation associated with those costs,
12 some environmental costs that might otherwise not be
13 covered, and it was provided for under Senate Bill 221.

14 Q. Now, in the increases from the RSP of three
15 and seven percent for the different Companies, do you know
16 whether those increases primarily reflected environmental
17 costs?

18 (PAUSE)

19 A. No, they did not.

20 Q. And, what other costs were included?

21 A. They were not a cost based value.

22 Q. But, in increasing the rates by three and
23 seven percent did the Company have to go in and get
24 permission from the PCO to implement those increases?

25 A. We had the authority to implement those

1 increases as part of our Rate Stabilization Plan.

2 Q. Without additional authority of the
3 Commission?

4 A. It was provided for in the Orders we received
5 in our Rate Stabilization Plan.

6 Q. I understand that, but did you... did you
7 then later have to go to the Commission and make a showing
8 about the costs associated with those increases or were they
9 just automatically implemented?

10

11 HON. RESNIK: Excuse me, again, I have to
12 object to the part of the question that says,
13 "the cost associated with those increases",
14 the witness has testified here---

15 HON. ROBERTS: Yeah, well, I---

16 HON. RESNIK: --increases were not a part
17 of---

18

19 BY HON. ROBERTS:

20 Q. Were those increases---

21

22 COURT REPORTER: They can't talk over each
23 other.

24

25

1

2 BY HON. ROBERTS:

3 Q. ---automatically implemented or did the
4 Company have to go to the Commission and make a showing
5 before the increases were implemented?

6 THE WITNESS:

7 A. The Company did not have to make a showing to
8 implement the five... or the three and seven percent
9 increases for 2006, 2007 and 2008; they were provided for in
10 the RSP.

11 Q. Okay. And, in the futures for this... for
12 this case, the ESP, why do you think you need these amounts
13 during the ESP period?

14 A. I answered that question already.

15 Q. Okay.

16 (PAUSE)

17 Q. And, are these increases applied to the non-
18 base rate portion of the Company's rates?

19 A. Could I have that read back?

20 Q. What do they... let me start over.

21 What are the increases applied to?

22 A. The non-fuel portion of rates.

23 Q. Okay.

24

25 HON. RESNIK: Generation rates?

1

2 THE WITNESS:

3 A. I'm sorry of generation rates.

4 BY HON. ROBERTS:

5 Q. Okay.

6 (PAUSE)

7 Q. During the 2006 to 2008 period you've
8 testified that there was virtually no switching CRES
9 providers; is that correct?

10 (PAUSE)

11 THE WITNESS:

12 A. Can you point me to some place in the
13 testimony?

14 Q. Well, we just discussed this earlier.

15 A. I believe---

16 Q. I asked... I asked... if I can find in my
17 notes; how many customers switched to competitive suppliers
18 earlier.

19 A. I don't---

20 Q. Let me just re-ask the question, if that will
21 help.

22 A. I don't---

23 Q. During the 2006 to 2008 period did you have
24 any customers that shopped?

25 (PAUSE)

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1 A. Let me... let me clarify something first. I
2 believe the discussion we had earlier was municipal or
3 governmental aggregation.

4 Q. That's correct.

5 A. All right. That was the question you asked.
6 Are you asking a question about municipal and government
7 aggregation or are you asking a question about customers
8 shopping?

9 Q. I asked... I'm asking you a question about
10 whether any customers shopped, which would in the universe
11 of customers, include aggregation, which I think Mr. Baker
12 has already answered.

13 A. That is correct. I dealt with the
14 aggregation question, both governmental and municipal. We
15 had some customers that shopped in Columbus Southern and I
16 believe we have some that are still shopping. I don't
17 believe we had any customers shopping in Ohio Power.

18 Q. And, is this information available somewhere,
19 do you have to file Reports with the Commission or otherwise
20 account for what customers are shopping?

21 A. That's an area that I don't know.

22 Q. And, do you know what Department in AEP would
23 collect that data?

24 (PAUSE)

25 Q. I'm just trying to get a better handle on

1 where I might be able to find out what that data is?

2 A. I believe that could be gotten from AEP Ohio.

3 Q. Okay.

4 (PAUSE)

5 Q. During that 2006 to 2008 period did the
6 Company's generation rates as compared to the market rates
7 result in lower, higher or rates that were the same as the
8 market rates during that period?

9 (PAUSE)

10 A. I'm sorry, can you read that back again or
11 can she---

12 Q. Do you want me to just ask it again?

13 A. Yes, that probably would be easier.

14 Q. Okay. During the time period 2006 to 2008
15 were the Company's generation rates... how did the
16 Company's generation rates compare to the market rates
17 during that period?

18 (PAUSE)

19 Q. And, by that I'm asking higher, lower, about
20 the same?

21 (PAUSE)

22 A. I think you have... you obviously need to
23 look at it from a customer class stand point, but in the
24 aggregate I would... the rates for AEP Ohio, Ohio Power and
25 Columbus Southern's generate rates would have been lower

1 than market.

2 Q. And, do you think that that would have an
3 impact on customer shopping?

4 (PAUSE)

5 A. Yes.

6 Q. And, what do you think that impact would be?

7 A. I think customers generally act in an
8 economically rational fashion and if tariff rates are below
9 market they will continue to buy at tariff. If market rates
10 are below tariff I think they will buy it from the market.

11 Q. During the period 2008 and forward will
12 customers be able to bypass the FAC increases by shopping?

13 (PAUSE)

14 A. Yes.

15 (PAUSE)

16 Q. Do you know where I can find this information
17 without asking you, because you probably don't have it with
18 you, the Company's projected Capital Investments in
19 Environmental Compliance Facilities for 2006 through 2008?

20 (PAUSE)

21 Q. Would that be in a Commission filing?

22 A. I'm sorry, could you... could you give me
23 that again?

24 Q. I'm looking for the Company's Capital
25 Investments in Environmental Compliance Facilities from 2006

1 to 2008; would that information be available in a Company
2 filing or some other place?

3 (PAUSE)

4 Q. So that I could find it?

5 A. The place that I would look would be in Mr.
6 Nelson's testimony.

7 Q. Okay.

8 (PAUSE)

9 Q. Does the Company speed up activities to
10 comply with Environmental Rules ahead of schedule?

11 (PAUSE)

12 A. That's a very hard question to answer.

13 (PAUSE)

14 A. As I'm thinking about it, what we needed to
15 do was meet certain compliance requirements, but given the
16 size of the Company and given the amount of facilities that
17 we needed to make environmental retrofits, we needed to do
18 that in an effective manner that would be cost efficient and
19 allow us to implement it and implement it by a certain...
20 by the date that we were required.

21 We couldn't... you couldn't create a
22 vehicle... you couldn't create a mechanism that you
23 scheduled all of your environmental retrofits to finish on a
24 specific date. You couldn't find the equipment, you
25 couldn't find the people, you couldn't manage that kind of

1 exercise. So, what we did was develop a Plan to be in
2 compliance by the date... the dates that were required.

3 Q. Did these actual expenditures relate to the
4 three and seven percent increases?

5 Did you testify they didn't?

6 A. I said that those increases were not cost
7 based.

8 Q. I understand that the expenditures for
9 environmental... uh...

10 I just want to confirm that the expenditures
11 for the environmental mandates are not related to the three
12 and seven percent increases?

13 (PAUSE)

14 A. The three and seven percent increases were
15 not cost based. What we did was we indicated when we made
16 the RSP filing of the... we had chose those percentages as
17 an attempt to be at or near market rates by 2009.

18 Q. Okay.

19 (PAUSE)

20 Q. And, the... so, because they're not cost
21 based they wouldn't be trued up; is that correct?

22 A. The... you have to break that out into two
23 pieces. The three and seven, they would not be in any way
24 trued up. The additional request under the four percent
25 provision there had to be an actual showing.

1 Q. Okay. And, are you able to opine as to
2 whether the three and seven percent was related to O&M or
3 return on expenditures?

4 A. The---

5 _____
6 HON. RESNIK: Are you talking about within
7 the Rate Stabilization Plan?

8 HON. ROBERTS: I'm talking about the three
9 and seven percent increases built into rates,
10 yes.

11 _____
12 BY HON. ROBERTS:

13 Q. Are the three and seven percent increases
14 built into the current rates, the proposed rates?

15 (PAUSE)

16 THE WITNESS:

17 A. I---

18 _____
19 HON. RESNIK: You mean as proposed in the
20 ESP?

21 HON. ROBERTS: Yes.

22 HON. RESNIK: Okay.

23 _____
24 THE WITNESS:

25 A. Now, wait a minute, I am confused now.

1 You... are we talking about the three and seven in the ESP
2 or the future three and seven in the RSP?

3 (PAUSE)

4 BY HON. ROBERTS:

5 Q. Well, I've talked about different ones at
6 different times. Just a second.

7 (PAUSE)

8 Q. So, let me try to back up here and be a
9 little clearer. Let's start with the future RSP, I think
10 that's what we were talking about before.

11 THE WITNESS:

12 A. Then some of my... most of what I've been
13 stating in the last five or ten minutes has been around the
14 ESP. Or the RSP, I'm sorry, that's right. Okay. We're
15 talking about the RSP?

16 Q. Yes.

17 Now, for the ESP do you propose similar
18 increases?

19 A. We---

20 Q. Of three and seven percent?

21 A. We proposed a three and a seven percent
22 increase annually in the non-fuel component of generation
23 rates.

24 Q. And, that's not based on cost?

25 A. It will be used to cover cost, but it is not-

1 --

2 Q. Right, and so three and seven percent isn't
3 based on cost that you propose to be compensated for?

4 A. They're---

5 Q. That you proposed in this application and
6 identify?

7 A. There is no specific cost justification, we
8 don't think that is required under Senate Bill 221 for the
9 automatic increases.

10 Q. Okay. And... and similarly there would be
11 no true up of these costs in the ESP costs for that reason?

12 A. Correct.

13 Q. Okay.

14 (PAUSE)

15 Q. Okay. The Capital Investments for
16 Environmental Compliance will affect the capacity
17 equalization rate and the equalization payments that the
18 Companies receive under the AEP Pool; is that correct?

19 (PAUSE)

20 A. You'll have to re-read that or give me that
21 question again.

22 Q. Let me rephrase it differently.

23 A. Okay.

24 Q. Regarding the Companies in the AEP Pool, the
25 more that's invested in plants the greater the installed

1 cost of capacity; is that correct?

2 A. Yes, that's correct.

3 Q. Okay.

4 (PAUSE)

5 Q. Ohio Power appears to have a surplus under
6 the Pool; is that accurate?

7 A. A surplus of what?

8 Q. A surplus... under the Pool Ohio Power is a
9 surplus Company?

10 A. From what stand point?

11 Q. On self-capacity?

12 A. They are a surplus company from a capacity
13 stand point, yes.

14 Q. And, for CSP, what's the status of CSP?

15 (PAUSE)

16 Q. In that regard?

17 A. They are very close to being a balanced
18 company.

19 Q. And, at the moment they are a surplus Company
20 or---

21 A. I don't have that data in front of me.

22 Q. Okay. So, they're close to being balanced?

23 A. Yes.

24 (PAUSE)

25 Q. Does the ESP Plan that has been filed by the

1 Company account in any way for the benefit derived by more
2 capacity equalization payments to OP as a result of the
3 environmental expenditures?

4 (PAUSE)

5 A. Can you do that one again for me, please?

6 Q. Does the ESP Plan filed by the Company
7 account in any way for the benefit derived by more capacity
8 equalization payments to OP as a result of the environmental
9 expenditures?

10 (PAUSE)

11 A. There is no credit for capacity equalization
12 receipts that Ohio Power may receive in the Plan.

13 Q. And, why is that?

14 (PAUSE)

15 A. The Plan covers the Fuel Adjust Clause as
16 we've defined it, does not include capacity receipts.

17 Q. Are there... would there in fact be capacity
18 receipts by OP?

19 A. I would expect there will continue to be
20 capacity receipts under the Pool for Ohio Power Company.

21 Q. And, has the Company calculated the magnitude
22 of those receipts?

23 A. I don't have that data in front of me.

24 Q. Well, let me ask you, can you explain to me
25 how one would calculate the receipts that OP would... the

1 receipts to OP of OP for the environmental expenditures?

2 (PAUSE)

3 Q. The receipts... I'm sorry, let me just say
4 that clearer.

5 Can you tell me how someone would calculate
6 the benefit of the capacity equalization payments to OP?

7 (PAUSE)

8 A. The capacity equalization receipts are the
9 amount of megawatts that Ohio Power is surplusd times a
10 capacity equalization rate.

11 Q. Okay.

12 A. And, that's done on a monthly basis.

13 Q. All right.

14 (PAUSE)

15 Q. I'm just going through my notes, I think
16 we've covered a lot of what I had here. Just give me a
17 second.

18 (PAUSE)

19 Q. Regarding the fifteen percent annual total
20 rate increases that the Company proposes in its ESP; can you
21 tell me who in the Company determined that that was the
22 appropriate... an appropriate ceiling on the... in those
23 increases?

24 (PAUSE)

25 Q. I guess I should say not a ceiling.

1 Can you tell me who in the Company determined
2 that was an appropriate target?

3 A. Yeah, let me... let me make it clearer. It
4 is a target, as you've described it, that we are talking
5 about here. Its not automatic increases of fifteen percent,
6 it is a target considering cost.

7 Who is the person who did that? I am.

8 Q. I'm sorry, I didn't hear the last thing you
9 said, Mr. Baker?

10 A. The... the... the parties who made a
11 determination that that was an appropriate target were
12 myself and Joe Hamrock.

13 Q. Okay.

14 (PAUSE)

15 Q. What kinds of information did you evaluate in
16 setting this target?

17 A. The target was taking into account what we
18 thought was an economy that was in difficult position in
19 Ohio and customers who were experiencing difficulty; and
20 looking at it and recognizing that based on a pure, just
21 looking at the change in fuel costs, rates would increase
22 more than the fifteen percent and we chose the fifteen
23 percent to moderate the impact on customers as well as to
24 not create too large of a deferral balance at the end of the
25 Plan. We were balancing those things.

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1 In looking at it we looked at the competitive
2 aspects of it, and said that when you look at that relative
3 to States around us, and that was the twenty to thirty-four
4 percent, those numbers looked reasonable.

5 Q. I have a couple of questions about
6 securitization.

7 You discussed securitization on page 23 and I
8 think... I know that on line 6 and 7 you indicate that a
9 AAA credit rating has been used by other utilities for
10 securitization?

11 A. Yes.

12 Q. And, can you identify any of those other
13 utilities for me?

14 (PAUSE)

15 A. Yes, we have... that's one of our Texas
16 utilities use securitization with a AAA credit rating in
17 regards to stand cost.

18 Q. And, when was that?

19 **A.** That would have been in the...

20 (PAUSE)

21 **A.** Approximately the 2005 time frame.

22 Q. Okay.

23 (PAUSE)

24 Q. And, what have you done to try to make the
25 changes in the Ohio Law to permit securitization on the

1 basis that you've described in your testimony?

2 (PAUSE)

3 A. The... during the period of the pendency of
4 Senate Bill 221 we indicated that there would be... need to
5 be revisions to Senate Bill 221 if parties wanted to use
6 securitization in the most economic fashion, we brought that
7 to the attention of the Legislature.

8 Q. And, generally speaking those changes would
9 be clarity through Legislation that these costs will be
10 recovered and that they'll be... there will be a guarantee
11 of the recovery of these costs by... well, would it be by
12 the State?

13 A. It wouldn't... it would not be State backing
14 if that's the question you're asking, financial backing. It
15 would be an assurance that the rate... that the securitized
16 values, including the interest payments, would be
17 collectable from rate payers for the full period of the
18 securitization.

19 Q. And, that is why the AAA rating was achieved
20 with those assurances?

21 A. I believe that's what a Bond-holder is going
22 to want as assurances in order to give a AAA rating.

23 Q. Okay. Thank you.

24 (PAUSE)

25 Q. I have some just kind of miscellaneous

1 questions to ask you about and so I'll try to wrap those up
2 pretty quickly.

3 Regarding the IGCC Plan, in your testimony
4 on, and I believe it's pages 52 to 56. I don't see that you
5 asked the Commission for anything in the ESP case as it
6 relates to the IGCC.

7

8 COURT REPORTER: I'm sorry---

9 THE WITNESS: IG---

10

11 BY HON. ROBERTS:

12 Did I read that correctly?

13 (PAUSE- WHILE WITNESS REVIEWS DOCUMENT)

14 THE WITNESS:

15 A. Yes, we're not asking for anything as part of
16 the ESP Plan in regards to the IGCC.

17 (PAUSE)

18 Q. What is the current status of the IGCC Plan?

19 A. It is on hold.

20 Q. It's on hold.

21 (PAUSE)

22 Q. And, you're also trying to address areas
23 created to the IGCC Plan in SB 221, are you not?

24 A. We indicated in various Legislative forums
25 that we did not believe that the Bill as drafted would meet

1 the needs of parties to bill new base load capacity in
2 general and specifically the IGCC.

3 Q. Did you receive about \$24 million from
4 customers for Phase I of the IGCC?

5 (PAUSE)

6 A. We...

7 (PAUSE)

8 A. I'm sorry, do that question again, if you
9 wouldn't mind, Mrs. Roberts.

10 Q. Did you receive about \$24 million from
11 customers as result of the PCO Order for Phase I of the
12 IGCC?

13 A. I believe we did.

14 Q. And, have you credited that \$24 million back
15 in the filing to the customers?

16 A. No. We don't believe that that's
17 appropriate. It was a cost that the Company incurred as far
18 as preconstruction costs in order to go forward with
19 analyzing and developing what was called the "Feed Study"
20 for the IGCC.

21 Q. Okay. So, you have no... you have no
22 intention of refunding those costs?

23 A. The provision... there is no provision in
24 the ESP for a refund of the costs that... or for the
25 revenues that the Company received for the costs that it

1 incurred.

2 Q. Okay. On page 51 of your testimony you
3 discuss a possible early Plant closure.

4 Do you recall that?

5 A. Yes.

6 Q. Are you referring to Generation Stations?

7 A. Yes.

8 Q. Which, if any, of the AEP's generating Plants
9 do you expect to have to close prematurely?

10 A. We don't expect that any of the Plants will
11 close during the period of the ESP. What this is dealing
12 with is with the potential. We had a situation where we had
13 to retire Columbus Mill I and II, Columbus... which were
14 Columbus Southern Plants during the period of the ESP and we
15 didn't have anything to deal with that in our ESP Plan and
16 so the Companies had to take a write-off associated with the
17 closure of those Plants under the ESP. And, we wanted to
18 put a place holder in the event that that happens during the
19 period of the ESP.

20 Q. And, how would I be able to find out what the
21 book value of each Plant is or how much remains to be
22 depreciated currently?

23 (PAUSE)

24 A. I believe you could find that information on
25 FERC Form 1's.

1 Q. FERC Form 1.

2

3 COURT REPORTER: I didn't understand---

4 THE WITNESS: FERC---

5

6 BY HON. ROBERTS:

7 Q. Okay. Under the---

8 THE WITNESS:

9 A. Hold on.

10

11 THE WITNESS: F-E-R-C Form I.

12 COURT REPORTER: Form I. I'm sorry, y'all
13 are totally losing me on these acronyms.

14

15 BY HON. ROBERTS:

16 Q. Do you recall addressing single issue rate
17 making in your testimony?

18 THE WITNESS:

19 A. I do recollect that I did that I did... that
20 I have mentioned it. So, if you want to point me somewhere
21 we can talk about it.

22 Q. All right. On page 17.

23 (PAUSE- WHILE WITNESS REVIEWS DOCUMENT)

24 Q. And, I'm sorry, I don't have a line number.

25

1 MRS. SMITH: 13. Line 13.

2 HON. ROBERTS: 1-7. Oh, line 15.

3 MRS. SMITH: Line 13.

4 HON. ROBERTS: 13, thank you.

5

6 THE WITNESS:

7 A. Yes.

8 BY HON. ROBERTS:

9 Q. You indicate that single issue rate making
10 for distribution service is one of the features of the ESP
11 that makes it more favorable.

12 THE WITNESS:

13 A. Yes.

14 Q. In the MRO?

15 A. Yes.

16 Q. Can you explain to me how single issue rate
17 making is more favorable to rate payers?

18 A. Well, first of all I believe that the
19 Legislation provides for it and I would think that... that
20 a... in the work coming up with that that they saw a value
21 for customers.

22 When I think about it I believe it can allow
23 you to get started on some infrastructure rebuild that is
24 necessary on the system and would provide enhanced service
25 to customers quicker than you would if you had to go through

1 a full distribution rate case before you could start to
2 spend the money.

3 Q. Is that the basis of your suggestion that it
4 would be less favorable through an MRO than an ESP?

5 (PAUSE)

6 Q. The single issue rate making?

7 A. We're showing that we think it is an
8 additional benefit of an ESP that we don't think you could
9 do under an MRO.

10 Q. And, is it prohibited under an MRO?

11

12 HON. RESNIK: I'll object to the extent that
13 its asking the witness for a legal
14 conclusion. If he can take a stab at it,
15 you can try.

16

17 THE WITNESS:

18 A. I don't know how a... the Commission would
19 deal under Senate Bill 221 with a request for a single issue
20 rate making for distribution.

21 BY HON. ROBERTS:

22 Q. But, under an MRO couldn't the Company...
23 the Company, you testified, could file it in a distribution
24 rate case, but you're just saying that would be a timely...
25 that would... that would be more time consuming and there

1 would be a lag in the recovery of the expenditures?

2 THE WITNESS:

3 A. We---

4 Q. Is that what you said?

5 A. We believe that having single issue rate
6 making avoids the lag and is more prompt from a decision-
7 making stand point on the Commissions' willingness to
8 support the enhancements to the distribution system that are
9 outlined on lines 14 and 15.

10 Q. And, another benefit of the ESP you cite is
11 that under an MRO shareholder funded commitment that
12 focused on economic development and low income customer
13 assistance might not be offered?

14 (PAUSE)

15 A. That's correct.

16 Q. And, why would that be?

17 A. Because the Company made that decision as
18 part of its ESP package.

19 Q. But, under an MRO couldn't you re---
20 couldn't you request low income customer assistance as part
21 of the distribution function?

22 (PAUSE)

23 A. I don't know.

24 Q. Do you have that in the distribution rates
25 now, low income customer assistance?

1 A. We have a certain amount of it, yes.

2 Q. And, some economic development rates... some
3 economic development funding?

4 (PAUSE)

5 Q. Is that correct?

6 A. We have some at this point.

7 Q. All right. And, you could ask for it in the
8 future, even with an MRO, couldn't you?

9

10 HON. RESNIK: That's just asking for a legal
11 conclusion, I object.

12 (PAUSE)

13 HON. ROBERTS: Are you going to have him
14 answer, if he can?

15 HON. RESNIK: He can take a stab at it.

16

17 THE WITNESS:

18 A. I don't know what the Commission, as I said
19 before, would approve under an MRO, that's to be determined.

20 BY HON. ROBERTS:

21 Q. But, the shareholders could still fund a
22 commitment in a distribution rate to these Programs,
23 couldn't it?

24 THE WITNESS:

25 A. I think you... I don't understand your

1 question. You say, "shareholders could fund in a
2 distribution rate", I don't know what that means.

3 (PAUSE)

4 Q. Well, in the ESP isn't there a shareholder
5 funded commitment focused on economic development and low
6 income customer assistance?

7 A. Yes.

8 Q. And, shareholders could make the same
9 commitment, could they not, in a distribution rate case
10 filing?

11 (PAUSE)

12 A. They could. I don't know if they would.

13 Q. All right. I have a question... I think one
14 question on loss adjustments. Sorry to be switching around,
15 I'm just trying to wrap up my questions here.

16 On page 13 there are adjustments for line
17 losses shown on the table. On the table. Do you want to
18 turn to page 13?

19 A. Yes.

20 (PAUSE- WHILE WITNESS REVIEWS DOCUMENT)

21 Q. Can you explain why the OPC line losses is
22 lower for the residential class line and in CSP it's higher;
23 can you explain that difference?

24 (PAUSE- WHILE WITNESS REVIEWS DOCUMENT)

25 A. I'm sorry, would you do that question one

1 more time?

2 Q. Sure.

3 For OPC the line loss is lowest for the
4 residential class.

5 A. Uh huh (yes). Yes.

6 Q. While in CSP it's highest for the residential
7 class.

8 Do you know if that's just a typographical
9 error, or if its not, why that would be?

10 (PAUSE- WHILE WITNESS REVIEWS DOCUMENT)

11 A. I don't know.

12 Q. Okay. Let me write that down.

13 (PAUSE)

14 Q. Regarding the APC sample swap. In discussing
15 that you indicated that you gathered information from a
16 third party regarding the APC sample swap, market price
17 data.

18

19 HON. RESNIK: Are you saying "sample"?

20 HON. ROBERTS: Simple, I'm sorry.

21 HON. RESNIK: Okay.

22 HON. ROBERTS: Simple swap.

23

24 THE WITNESS:

25 A. Yes.

1 (PAUSE)

2 BY HON. ROBERTS:

3 Q. And, does the third party consist of a single
4 number per day or an on and off peak number per day?

5 (PAUSE)

6 THE WITNESS:

7 A. It was from plats and I---

8 Q. Plats?

9 A. ---and I believe that was a twenty-four our
10 number.

11 (PAUSE)

12 Q. Okay.

13 (PAUSE)

14 _____

15 COURT REPORTER: Can we possibly take about
16 five minutes?

17 (PAUSE)

18 COURT REPORTER: This is the Court Reporter.

19 HON. ROBERTS: Okay. Then we'll be off the
20 record.

21 _____

22 (AT THIS POINT IN TIME A SHORT
23 RECESS WAS TAKEN FROM 9:45AM
24 TO 9:58AM CDT)

25 _____

1 BY HON. ROBERTS:

2 Q. On the chart you have on page 13... the
3 charts you have on page 13.

4 (PAUSE- WHILE WITNESS REVIEWS DOCUMENT)

5 THE WITNESS:

6 A. Okay.

7 Q. On the top chart you identify losses, and
8 would those be distribution losses?

9 A. Transmission losses, I believe.

10 Q. All right.

11 A. And, they may be distribution as well, but
12 certainly transmission losses.

13 Q. I understand the transmission losses, why
14 would it be appropriate to include distribution losses?

15 A. I said it might, I don't know that it does.

16 Q. Okay.

17 A. I know that it includes transmission losses.

18 Q. All right.

19 (PAUSE)

20 Q. The requirements for the ARR Credit and the
21 Transaction Risk Rider... Risk Adder.

22 A. Yes.

23 Q. Can you tell me how those were derived?

24 A. Well, the ARR Credits are our projections of
25 what the values associated with having what were at one

1 point were called FTR's, Financial Transmission Riders---

2 Q. Yeah.

3 A. ---or Financial Transmission... right.

4 Um... the Transaction Risk Adder was... we looked at what
5 had been developed in other States for that kind of factor
6 and included that based on what we thought would be the
7 price if we went out and tried to solicit a supply.

8 Q. And, for the Retail Administration Cost is
9 based on what you've seen in Connecticut for example?

10 A. Other States.

11 Q. In other States?

12 A. Yes.

13 Q. Are there other States other than Connecticut
14 that have a Retail Administration Cost that you're aware of?

15 A. I just... I know that when we were doing
16 this we looked at costs in Connecticut, costs in New Jersey,
17 Maryland, Illinois, we looked at a number of States in
18 coming up with this composite.

19 Q. All right. I'll follow up with that in an
20 Interrogatory, so we don't have to talk about it.

21 (PAUSE)

22 BY HON. ROBERTS:

23 I don't think I have any other questions.

24 Thank you, Mr. Baker, I really appreciate you being
25 available today to answer questions for us.

1 THE WITNESS:

2 All right.

3

4 CROSS EXAMINATION

5 BY HON. PETRICOFF:

6 Q. Good morning, Mr. Baker, this is Howard
7 Petricoff.

8 THE WITNESS:

9 A. Good morning, Mr. Petricoff. How are you
10 today?

11 Q. Oh, fine. And, you certainly can feel free
12 to call me Howard, especially since we're doing this on a
13 Saturday.

14 A. Okay.

15 Q. You indicated earlier that you did have your
16 testimony near you. If you would, could you open to page
17 18?

18 A. Okay. I have it open.

19 Q. Okay. And, on line 15 it says that;
20 "The FAC is an appropriate way to
21 reflect changes in the costs of various
22 components of the FAC."

23 Which you'll agree with me is an acronym for
24 the Fuel Adjustment Clause?

25 A. Yes, I would agree with that.

1 Q. Okay. Let's take a minute or two to just
2 reflect what are all these cost components that are in the
3 FAC.

4 This would include coal?

5 A. It would be... includes the cost of coal
6 that we had burned, yes.

7 Q. All right. And, natural gas?

8 A. Yes.

9 Q. Fuel oil?

10 A. Yes.

11 Q. Purchase power on the open market?

12 A. Yes.

13 Q. Anything else in the Fuel Adjustment Clause
14 besides those items?

15 A. There would be charges for AEP Pool capacity
16 and energy.

17 Q. Okay. Could you explain that charge to me?

18 A. That is a charge when if the Companies,
19 either OPCO or CSP purchases... effectively has a capacity
20 equalization charge, if they did, and which is determined on
21 a monthly basis and then purchases that may be... that
22 would be made as part of the hourly fuel... or the hourly
23 pool settlement.

24 Q. Would---

25 A. The---

1 Q. ---there also be credits going in the other
2 direction?

3 A. There would be credits for the fuel
4 associated with sales, yes.

5 Q. Okay.

6 (PAUSE)

7 Q. Any other components in the FAC?

8 A. I would recommend you look at Mr. Nelson's
9 testimony, who has outlined all of them.

10 Q. Okay. Thank you.

11 (PAUSE)

12 Q. Now, if a customer is shopping would he
13 create any costs that would be collected through the FAC?

14 (PAUSE)

15 A. No.

16 Q. Okay. And, in fact, the FAC would be
17 bypassable by a shopping customer?

18 A. The FAC would be bypassable.

19 Q. Okay.

20 (PAUSE)

21 Q. Now, I'd like to draw your attention to the
22 line on... I'm still on page 18, and look at line 18, where
23 you make reference to Section 4928.02(G) of the Ohio Revised
24 Code.

25 A. Yes.

1 Q. Okay. Are we continuing to see the emergence
2 of a competitive electric market in Ohio?

3 (PAUSE)

4 A. Yes, I think there is a very competitive
5 electric market in Ohio.

6 Q. Okay. Now, it says here, "competitive
7 electric markets" and I want to break that down a bit.
8 Let's talk about the wholesale market.

9 Is there a robust wholesale market in Ohio?

10 A. Yes, I believe there is.

11 Q. And, is there a retail market in Ohio?

12 A. There is availability to... of a retail
13 market I believe through the RTO's, I don't believe it is
14 being used very much by customers.

15 Q. Okay.

16 (PAUSE)

17 Q. So,---

18 A. Certainly, I... let me just amend that, if
19 you wouldn't mind, Mr. Petricoff.

20 Q. Sure.

21 A. I'm talking about Ohio Power and Columbus
22 Southern when I make that statement. I have not done a full
23 analysis of First Energy or the other two Companies.

24 Q. Okay. I think my question was, was the State
25 of Ohio, but quite frankly in this case we're more

1 interested in just the service territories, the AEP Ohio
2 service territories.

3 So, let's just consider that for my questions
4 from here on out that we're only looking at the AEP Ohio
5 service territories?

6 A. Thank you, that will be helpful.

7 Q. When I say territories. Okay, good.

8 Will the ESP... well, let me put it this
9 way, do the Ohio operating, the AEP Ohio operating Companies
10 have a Policy as to fostering development of a retail market
11 in their service territory?

12 (PAUSE)

13 A. The Company has done what it can to foster
14 the market, and we believe that what we're doing with this
15 kind of filing does everything to help that market move
16 along within the parameters of Senate Bill 221.

17 Q. So, there is a goal to assist the development
18 of the retail market when practical?

19 A. We are... we are doing what we can. We
20 have... we created systems to provide for customer
21 switching, we're active in the wholesale market, which we
22 believe is a facilitator of retail markets.

23 (PAUSE)

24 Q. Okay. Anything else come to mind?

25 A. Participation in RTO's.

1 (pause)

2 Q. Okay. Now, if you would, I'd like for you to
3 turn to page 20 of your testimony.

4 A. Okay.

5 Q. And, here we start the discussion of the
6 phase-in. And, first let's look at the goal of the phase-
7 in.

8 Is it fair to say that the... I'm sorry.

9 (PAUSE)

10 Q. Okay. I thought maybe you were... that's
11 part of the problems with a telephone deposition, you can't
12 see anyone. Turning to page 20 then of line 7; where we're
13 talking about the goals of the phase-in.

14 Is it true that the phase-in is just for FAC
15 charges?

16 A. Yes. That's what it---

17 Q. Suggesting that the purpose of the phase-in
18 is gradualism as experienced by the retail customer?

19 A. Um... gradualism is not a word that I
20 generally use, but the intent is to moderate the impacts on
21 customers of the fact that fuel costs are rising at a very
22 high rate, so that may be termed gradualism, but that's my
23 definition.

24 Q. Okay.

25 (PAUSE)

1 Q. Since the shopping customers do not pay the..
2 well, let me go... let me retract that first. Let me ask
3 another question.

4 Mechanically how will the phase-in be handled
5 for the FAC; and specifically will the Company calculate the
6 full FAC and then apply a credit?

7 (PAUSE)

8 A. The attempt would be to just... to phase-in
9 the charges in the FAC. Yes, we will have to determine the
10 full FAC in order to create the deferral balances.

11 Q. Okay. Would it be accurate to say then that
12 the full FAC charges will be calculated and assessed, but
13 the payment of those charges will be deferred?

14 Or a portion of the payment of those charges
15 will be deferred?

16 A. Can I... can you define the word, "assessed"
17 for me. I can buy that it would be calculated and a portion
18 of them would be deferred and not collected in the current
19 FAC.

20 Q. Okay. Let's just say, we'll make it simple,
21 you have... you have one customer and the total FAC for the
22 one customer for, you know, January 1st, 2009 was \$10.00.

23 Would the Company then book that they have...
24 had sold \$10.00 of... or have an asset of \$10.00 for the
25 sale of at least the FAC portion of power?

1 (PAUSE)

2 A. To make things... this a little easier,
3 let's just assume that the cost was \$10.00 and to stay
4 within the fifteen percent cap that meant that we could
5 charge \$5.00; and you'll go with me down this path.

6 That would say that we would collect the
7 \$5.00 from that customer in the FAC and we would set up a
8 regulatory asset equivalent to the remaining \$5.00.

9 Q. Okay.

10 (PAUSE)

11 Q. And, then let's take that a step further. On
12 2012 then the Company would have some type of rider to
13 collect... to start collecting back that \$5.00 that we
14 deferred in this example?

15 A. Yes, the intent would be to collect that over
16 future years.

17 Q. And, there would be carrying costs associated
18 with that deferral and subsequent collection?

19 A. Yes, that's correct.

20 Q. Okay. Is it a fair characterization then to
21 look at the phase-in as a loan to the customer, that
22 basically we are loaning him a portion of the cost of his
23 power and then billing him for it later?

24 A. Um...

25 (PAUSE)

1 A. It is... I'm not sure I would characterize
2 it as a loan. I think people... I just see a methodology
3 that has been used at other times in periods where rates
4 have increased where you set up... or Companies set up a
5 regulatory asset, is able to collect carrying charges on
6 that regulatory asset since they don't have the dollars and
7 you collect it from customers in a future time frame.

8 (PAUSE)

9 Q. If we're looking at the... at the cost and
10 benefits of the phase-in then the benefit would be at least
11 a partial delay in paying what is now an obligation of the
12 company for fuel and the cost would be... the carrying cost
13 for the time value of that delay?

14 A. Yes, I can accept that.

15 Q. Okay.

16 (PAUSE)

17 Q. Now, we talked earlier about the... that the
18 FAC is made up of various fuel and power cost components.
19 Let's look at the fuel first.

20 Since the time that the Application was filed
21 has there been a decrease in the cost of natural gas, coal
22 and fuel oil?

23 (PAUSE)

24 A. I know that there has been a decrease in the
25 cost of fuel oil and natural gas since the filing; I don't

1 know how much there has been a decrease in the cost of coal.

2 Q. Okay. Let's say hypothetically that there
3 was a significant decrease in the cost to AEP for these fuel
4 components, would the deferral be changed in the phase-in if
5 the fuel cost went down and the... let's see.. Oh,
6 actually just leave it that way.

7 Would there be a change in the part that's
8 been deferred because of a decrease in the FAC charges?

9 (PAUSE)

10 A. Relative to higher prices, yes.

11 (PAUSE)

12 A. Okay, I mean---

13 Q. Yeah, I want to take it a step--- thank you,
14 and that was responsive to my question. I want to take it a
15 step down and look at a somewhat lower level.

16 On line 7 and 8 we talk about that the goal
17 for setting the deferral was so that the increase to the
18 customer would be about in the fifteenth percent range
19 overall.

20 A. Yes.

21 Q. Do you see where I'm referring to?

22 A. Yes, I do see it.

23 Q. Okay. If we had a precipitous drop in the
24 cost of fuel and power components in the FAC, would the
25 deferral have an immediate adjustment, a month to month

1 adjustment?

2 (PAUSE)

3 A. I would ask you to look at Mr. Nelson's
4 testimony on whether that would be month by month, but the
5 idea from a concept stand point would be that if the amount
6 of deferrals on an annual basis, because I'm thinking of
7 this as an annual fuel clause---

8 Q. Sure.

9 A. ---would be lower, all other things being
10 held equal if the price of fuel dropped precipitously than
11 it would be if it didn't drop.

12 Q. Okay.

13 A. So, you see in other words---

14 Q. Yeah. So, basically just looking at the
15 mechanics of it on an annual basis, the fee that would be
16 charged to the retail customer would remain the same and the
17 adjustments because of changes in fuel and purchase power
18 would come in the amount that is deferred?

19 A. That... that's... that's right.

20 Q. Okay.

21 (PAUSE)

22 Q. Now, earlier we indicated that a shopping
23 customer would bypass the FAC charge. So, is it fair to say
24 then that the shopping customer would get none of the
25 advantage of gradualism that the FAC is providing to the

1 standard service of a customer?

2

3 HON. RESNIK: Mr. Petricoff, if I can call
4 you Howard.

5 HON. PETRICOFF: Oh, absolutely, Marvin.

6 HON. RESNIK: And, now that you've talked
7 about deferrals, I just want to make sure
8 that we're all talking about the same thing
9 when you talk about bypassing FAC charges.
10 Because you get into situations where a
11 shopping customer may have been on our
12 system in 2009 or 2010 and responsible for
13 those deferrals; and I just want to make
14 sure that you and Mr. Baker are on the same
15 page when you're talking about not paying
16 any FAC charges.

17 HON. PETRICOFF: Okay. That's a helpful
18 clarification. So, let me go back and
19 start again with a different example.

20

21 BY HON. PETRICOFF:

22 Q. Let's say we have a customer who is shopping
23 now.

24 THE WITNESS:

25 A. Shopping today?

1 Q. Shopping... shopping today, right.

2 A. Got it, uh huh (yes).

3 Q. And, now the 200--- January 1st, 2009
4 account, that customer would continue to bypass the FAC;
5 correct?

6 A. They would bypass the FAC that would be
7 included in the rates in 2009.

8 Q. Right. And, they would have... there would
9 be nothing that would in the near term adjust their rates
10 down, because of the deferral; that's correct?

11 (PAUSE)

12 A. Their... they would be bypassing the rate
13 that was charged to other customers for generation service
14 in the year 2009. They would not be... there would be no
15 treatment about the deferrals.

16 Q. Right. And, then in the year 2012 when the
17 deferral collections began, wouldn't that customer have to
18 pay the deferral rider?

19 A. Yes.

20 Q. Okay.

21 (PAUSE)

22 Q. In that case, wouldn't that customer be
23 paying for a benefit that they didn't enjoy?

24 (PAUSE)

25 A. The...

1 (PAUSE)

2 A. The customer would be paying a non-bypassable
3 charge associated with a Commission Order. They chose not
4 to buy under the SSO rate and that's their prerogative,
5 because it was economically beneficial for them to do that.

6 (PAUSE)

7 Q. But, its true that they would be paying for a
8 benefit that would be enjoyed by other customers for which
9 they would not have any enjoyment?

10 A. They would be... they would be incurring a
11 charge as associated with the deferrals that came about as a
12 result of the Company not collecting its total fuel expense
13 from all its customers.

14 Q. Okay. Is there any reason that the Company
15 couldn't likewise give a credit to the shopping customer in
16 the amount of the FAC deferral that it charges the SSO
17 customers and then collect the deferral back in 2012 and
18 thereafter from my shopping customer in 2009?

19 When I say, "my shopping customer", I mean
20 the shopping customer in my example?

21 (PAUSE)

22 A. I don't believe the math works out, because
23 we are paying... we are giving a shopping credit larger
24 than...

25 (PAUSE)

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1 A. We're giving a shopping credit for a cost
2 that isn't incurred and I don't think we carry that shopping
3 credit out and put it in the deferral account. If you were
4 suggesting putting that, the charge or the credit that was
5 given to customers as an adder to the deferred balance it
6 might work.

7 Q. Okay. Do you know of any legal or accounting
8 reason why we couldn't put it in as an adder as you've just
9 suggested?

10 A. I haven't thought it through, Mr. Petricoff.

11 Q. Okay. But, that is a possibility?

12 A. I don't know.

13 (PAUSE)

14 Q. Let's talk about the price to compare, and
15 this time when I say, "the price to compare" and I'm
16 referring to the one that your Counsel asked for
17 clarification on earlier today in the deposition; and that
18 is the price to compare that appears on customers' bills.

19 Are you familiar with the price to compare
20 line that appears on customers' bills?

21 A. I... we can talk about it. I haven't looked
22 at that for a long long time. Probably not since we started
23 this.

24 Q. Okay.

25 (PAUSE)

1 Q. Is it your recollection that the company
2 bills... residential and other customers' bills a target
3 generation price that they could use to compare to see if
4 they could find a generation at a lower price than the
5 standard service offer?

6 A. Yes, I believe that's the case.

7 Q. Okay. Now, under your proposal in the ESP
8 here; would the price to compare be the price of generation
9 with the deferral or without the deferral?

10 A. I believe its without the deferral.

11 (PAUSE)

12 Q. So, if the FAC in our example that we used
13 before was \$10.00, and with the deferral it would only be
14 \$5.00; it would be the \$10.00 that would be used to compute
15 the price to compare?

16 A. No, it would be the \$5.00.

17 Q. Okay. Assuming that it is the \$5.00, then
18 wouldn't for competitive purposes CRES providers be facing a
19 competitive price that was being subsidized by future
20 collections in the amount of... our example here, in the
21 amount of \$5.00?

22 (PAUSE)

23 A. Could I have... could you rephrase or re-do
24 that one, Mr. Petricoff?

25 Q. Sure.

1 A. I'm sorry.

2 Q. Sure. If the price to compare that appears
3 on the bills---

4 A. Uh huh (yes).

5 Q. ---is going to reflect a reduction for the
6 deferral, then aren't competitors facing a price that is
7 being subsidized by a future collection?

8 A. I believe that they would... they are...
9 that they are looking at a price that is less than it
10 otherwise would be if we did not have the fifteen percent
11 target annual increase.

12 Q. And, wouldn't they be looking at a price to
13 compare that is actually less than what it costs the company
14 to provide that power under its standard service offer?

15 (PAUSE)

16 A. It would be less than the cost that we would
17 be incurring.

18 Q. Okay.

19 (PAUSE)

20 Q. Should the Company be concerned that that
21 type of comparison would harm development of the retail
22 market?

23 A. And, without knowing what the future for the
24 price of power is, I can't say whether it would harm it or
25 not. But, we have goals that we have outlined of trying to

1 help in general, the economy of Ohio by proposing this FAC
2 phase-in and that is just one of the results of it.

3 (PAUSE)

4 Q. Okay. Give me just a second here, because I
5 think I can eliminate a couple of questions because you were
6 asked them earlier this morning.

7 (PAUSE)

8 Q. Have you looked at fuel and power prices
9 since you filed your testimony?

10 (PAUSE)

11 Q. And, I'm talking now in the general... in
12 the general market, not wholesale?

13 A. In the general market I believe prices of
14 power are down somewhat, but I don't know what the
15 percentages are from when we filed. As I mentioned earlier,
16 it is my understanding that the price of fuel when you
17 consider gas and fuel oil are down, I don't know whether the
18 price of coal is actually down, if you can go out and find
19 it.

20 Q. In the preparation of your testimony did you
21 look at the forward power prices for 2009, 2010 and 2011?

22 A. Yes.

23 Q. Okay. And, have you had an opportunity since
24 you've filed your testimony to look at forward prices for
25 2009, 2010 and 2011?

1 A. I have not gone back and re-looked at them in
2 relationship to this testimony, no.

3 Q. So, at this point then is it fair to say that
4 you know that there's... that there's been a trend downward
5 in the forward curve for prices, but you, at this point,
6 have taken no steps to quantify that?

7 A. I... I'm not sure that we're on exactly the
8 same page.

9 Q. Oh, okay.

10 A. Uh...

11 Q. Well, correct me.

12 A. So, let me make sure. What I was talking
13 about was more the price in the stock market. I don't... I
14 have not done any analysis as to what the prices are, let's
15 say for nine... for strips nine, ten and eleven for these
16 various commodities.

17 Q. Okay.

18 A. I was looking at current delivery.

19 Q. Okay. So, its fair to say in summary, and
20 you know, please feel free to correct me if this is an
21 accurate summary;

22 That in the... you're generally aware that
23 in the stock market the prices are down and in the forward
24 curve you've not had an opportunity to really look at that?

25 A. That's correct.

1 Q. And, we say that the stock markets are down;
2 are you talking about the PJM L&P prices?

3 A. That's... that's one factor, and but looking
4 at what you can buy gas for in the short run, or fuel oil.

5 Q. Okay. So, it will also be the... Oh, let me
6 go back into those markets on a short term.

7 Do you look both at the dynamics of futures
8 as well as the physical markets?

9 A. Um... I don't know, this is information that
10 I pick up as part of my business activities from discussions
11 as opposed to actually looking at specific documents.

12 Q. Okay. Thank you. If you would, I'd like you
13 to turn to page 21 of your testimony.

14 A. Okay.

15 Q. Starting on page 11 I want to ask you about
16 these slice of the... slice-of-the-system.

17 A. I'm sorry, we're talking about page 11 or
18 page 21?

19 Q. Page 21, line 11.

20 A. Line 11?

21 Q. The question on line 11.

22 A. Okay, uh huh (yes).

23 Q. And, just to set the stage, this is where the
24 portion of your testimony when you're talking about that the
25 Company is going to go out and secure on the open market

1 five percent of the demand for 2009, ten percent for 2010
2 and fifteen percent for 2011.

3 A. Correct.

4 Q. Okay. Could you tell me a bit about the RFP
5 process you have in mind to accomplish these purchases?

6 A. I would expect that we would be doing an RFP
7 not just similar to what we did in the case of our
8 purchasing capacity and energy for the Mon Power load that
9 we did in the 2006 through 2008 time frame. Or, I'm sorry,
10 I think it was mid 2007 through 2008.

11 And, we sent out an RFP with a projection of
12 how many... how much capacity and energy we would need for
13 that period and ask for people to solicit... to solicit
14 interest and to receive bids that we could then evaluate as
15 to how well they would meet the slice-of-system requirement.

16 Q. Okay. Well, since my calendar says that
17 today is October the 25th, and 2009 is just a couple of
18 months away; do you have a target date for when this RFP
19 process would take place for the 2009 process, assuming
20 Commission approval?

21 A. I would assume we would do it as soon as we
22 get Commission approval.

23 Q. And, then once again, maybe at the risk of
24 being repetitious here, you're envisioning a process very
25 similar to what you used in the Mon Power, I'll call it an

1 auction, the Mon Power auction?

2 A. Yes.

3 Q. Okay.

4 (PAUSE)

5 Q. Now, let's---

6 A. Now, Mr. Petricoff, by that I mean the
7 design. I don't necessarily mean the time line. We may
8 have to have a faster time line.

9 Q. Oh, yeah. You know, I'm glad you brought the
10 subject back up, because with the... what I had in mind,
11 and now I'll be very specific;

12 It is that in terms of being a... you know,
13 a sealed bid and the kinds of purchase power contract that
14 that would be... that would flow from it and the way in
15 which the... you know, notice for sending in the...
16 "sending in" is obviously my term and not a scheduler's, but
17 sending in power... all of that would be similar?

18 A. I believe that would be the case, yes.

19 Q. Okay.

20 (PAUSE)

21 Q. Okay. Let's take a look at about how the
22 mechanics of that would work out within the AEP Power Pool.

23 In 2009 then I assume that five percent of the capacity
24 from Ohio Power and five percent of the capacity from
25 Columbus Southern Power would then go back in the AEP Power

1 Pool?

2 (PAUSE)

3 A. Um... the availability of the supply when it
4 was scheduled would go into the Power Pool.

5 Q. Okay. And, earlier we talked about how the
6 costs and credits for the Power Pool work, so we can assume
7 then that Columbus Southern Power and Ohio Power would then
8 be getting credits back from the sale of the energy and
9 capacity when it was used by other AEP Companies?

10 A. There would not be a capacity adjustment in
11 the Pool for these purchases, but the fuel associated with
12 the energy would be pulled out.

13 (PAUSE)

14 A. If it were... if it went to... well, what
15 would happen is that any energy that was provided by either
16 of the Companies to their sisters comes as a credit to the
17 FAC at the price that's determined by the Pool Agreement.

18 Q. Okay. So, there it is...

19 (PAUSE)

20 Q. Okay. Maybe I... I thought I understood it
21 and now I think maybe I don't. If you don't mind, let me go
22 back through---

23 A. Sure.

24 Q. ---back through this again.

25 A. Sure.

1 Q. Let's use a simple example. Let's say we
2 have... we have in... for a specific clock hour, we have a
3 10 megawatts and 10 megawatt hours of power that is now
4 released back to the Pool because of the five percent
5 purchase in 2009; so clock hour one in 2009, you know, 10
6 megawatts and 10 megawatt hours has now been freed up to the
7 AEP Pool.

8 Columbus Southern and Ohio Power would not
9 receive any payments for capacity or generation for making
10 that energy capacity available other than just a fuel
11 adjustment?

12 (PAUSE)

13 A. The Fuel Adjustment Clauses credit the fuel
14 related and... fuel related with sales made by a sister
15 company to its affiliate. So, what it collects from an
16 energy charge with the fuel gets built in gets credit back
17 to the Fuel Adjustment Clause.

18 (PAUSE)

19 Q. Okay. And, that is the only adjustment that
20 the Companies would see by virtue of making the additional
21 capacity and generation available to a sister AEP Company?

22 A. Well, you're making an assumption that it
23 makes more capacity and energy available. I'm not making
24 that assumption. I'm only saying to the extent that there
25 are sales of energy made by AEP Ohio Companies, Ohio Power,

1 Columbus Southern, the energy component serves as a credit
2 to the FAC.

3 There is no capacity adjustment because that
4 capacity will probably... is not expected to be included in
5 the capacity equalization payments.

6 (PAUSE)

7 Q. Okay. So, but there... there is... and
8 let's just go back to my example.

9 We've got clock hour one, 10 megawatts and 10
10 megawatts... oh, let's make it 10. 10 megawatt hours,
11 because now I think we've settled the capacity. Clock hour
12 one we've got 10 megawatt hours being sold from Ohio Power
13 to lets say Kentucky Power.

14 At that point what would be the payment back
15 from Kentucky Power to Ohio Power?

16 A. It would receive a payment based on Ohio
17 Power's average cost of energy produced in that first month
18 of January.

19 Q. Okay.

20 A. Times the 10... I believe you said 10
21 megawatt hours supplied by Ohio Power to Kentucky.

22 Q. Right. And, let's just take the example out
23 and once it gets... using simple math.

24 So, let's say that the price was \$10.00 of
25 megawatt hours. So, in that case there would be a payment

1 of \$100.00 that would come from Kentucky Power to Ohio
2 Power?

3 A. Yes.

4 Q. And, of that \$100.00 let's say that \$50.00 of
5 it was a fuel component, that \$50.00 would then be a credit
6 to the FAC?

7 A. That is correct. Using your example. I
8 don't think your numbers are necessarily correct
9 proportionately.

10 Q. Oh, no, we'll agree that the numbers were for
11 illustrative purposes, done to fulfill the needs that you
12 have for lawyer math.

13 A. And, that's fine.

14 (PAUSE)

15 Q. Okay.

16 (PAUSE)

17 Q. I think I need another minute or two because
18 I've got some questions here that I think have already been
19 asked.

20 (PAUSE)

21 Q. Okay. I think I'm now ready to move on to
22 the POLR charge, Provider of Last Resort, that is on page 25
23 of your testimony.

24 (PAUSE- WHILE WITNESS REVIEWS DOCUMENT)

25 A. Okay.

1 Q. Let's start at a very high level.

2 Is it fair to say that the goal of the
3 Provider of Last Resort is to put the Companies, Ohio Power
4 and Columbus Southern Power, in a position where they would
5 basically have the same earnings as if they had sold all the
6 power to all the customers at the ESP price under the ESP
7 Plan?

8 (PAUSE)

9 A. No, I wouldn't agree with that.

10 (PAUSE)

11 Q. Okay. Is the POLR charge then... let's see.

12 Well, let me see, why do you disagree with that statement?

13 A. I think, as we discussed earlier this
14 morning, the POLR charge reflects the value of the options
15 that customers receive under Senate Bill 221 where they can
16 effectively go to the market and give us the power back when
17 prices are below tariff and come back when prices are above
18 tariff.

19 And, it is a model that takes into account
20 the likelihood of that happening, so it is not a... in my
21 view a straight one for one that it absolutely matches if we
22 had been able to sell everything at tariff, because it takes
23 into account probabilities.

24 Q. I understand... well, help me. Is the...

25 Well, let's do this;

1 Turn to page 32 where we have the chart on
2 Black-Scholes.

3 (PAUSE- WHILE WITNESS REVIEWS DOCUMENT)

4 A. Yeah, okay, I'm there.

5 Q. Okay. And, now we're going across here. The
6 first... in the first block we have market price and the
7 market price you're using is the one that you've developed
8 in your MRO scenario?

9 A. Yes.

10 Q. Okay. And, that is the... that is the
11 compare to price that you have and then you compare that to
12 what you call the strike price, which is the proposed ESP
13 price as contained in the filing?

14 A. For year one.

15 Q. Right, for year one. And, just out of
16 interest, is that with the deferrals or without the
17 deferrals?

18 (PAUSE)

19 A. That would be without the deferrals, I
20 believe.

21 Q. That would be the full price and we're not...
22 we're not adjusting it... we're not reducing that down---

23 A. No, I believe---

24 Q. ---just because of the deferral?

25 A. I'm sorry. I believe when I say, "without

1 deferrals", I mean that it would be the charge that they
2 would otherwise get if they bought SSO, so the deferrals
3 would be separate from that.

4 So, using your example earlier, it would be
5 the \$5.00 rather than the \$10.00.

6 Q. Okay.

7 A. I believe that's the way we did it.

8 Q. Okay. And, then the time frame... the time
9 frame is the three years of the ESP?

10 A. Yes.

11 (PAUSE)

12 Q. And, going through... and, well, to continue
13 my way across; the interest rates were, you say a three year
14 Treasury Note; do you recall what that was for purposes of
15 your testimony?

16 A. No, I don't have that in front of me.

17 Q. Okay. And, is that a lower rate today than
18 at the time that you drafted your testimony?

19 A. I would expect that it may very well be, but
20 again, I don't know. I haven't looked at a future three-
21 year strip.

22 Q. Okay. And, then that brings us to the last
23 item, which is the volatility.

24 A. Yes.

25 Q. Now, looking at this model, what Black-

1 Scholes is supposed to do is to calculate the risks in
2 dollars, to the fact that customers might leave the Company.

3 I'm sorry, leave the Standard Service Offer and the Company
4 would be unable to be... to be compensated an amount that
5 was equal to the strike?

6 A. Yes, that's... I can accept that.

7 Q. Okay.

8 (PAUSE)

9 Q. Well, isn't that virtually the same as the
10 earlier statement then that the idea was supposed to make
11 the Company... put the Company in the same financial
12 position as if it had sold all the power at the ESP price?

13 (PAUSE)

14 Q. I mean I realize that the mechanics may not
15 get you there exactly, but isn't that the goal of the---

16 A. Well, and as I said---

17 Q. ---of the Program?

18 A. That was not the way we looked at it in
19 setting the goal. The goal was to determine the value the
20 customer receives and set a charge that's part of our ESP
21 that reflects that POLR responsibility.

22 So, when you were talking about "goal",
23 that's as why, in my view, why were you doing it; and that
24 was not the thought pattern and why I haven't been able to
25 quite get my arms around it, because that wasn't our way of

1 thinking. Whether that in fact gets the exact same result,
2 but that was not the goal of it.

3 Q. Okay. And, thank you, that's very
4 responsive. That's a very responsive answer. Let's take a
5 look at then, you know, in terms of looking at pricing
6 models.

7 You'll agree with me that the ESP is not on
8 cost to service principals?

9 A. I believe that it is not a classic cost of
10 service rate making approach.

11 Q. Right. But, there are some elements that use
12 cost of service, but its not... this is not designed to
13 be... to make rate through traditional cost of service?

14 A. That... I would agree with that.

15 Q. Okay. And, likewise, you... that is not...
16 cost of service or rate making is not required by SB 221?

17 _____
18 HON. RESNIK: And, I'll object as far as
19 asking for a legal conclusion. Witness
20 can try and answer.

21 _____
22 THE WITNESS:

23 A. Yeah, in my opinion Senate Bill 221 is not a
24 classic pure cost of service model, either in the way you
25 calculate rates or the fact that customers have choice.

1 BY HON. PETRICOFF:

2 Q. Okay. Now, if we were looking to put a label
3 on what the methodology is that's being presented here as to
4 the POLR charge; would it be fair to say, given our
5 discussion here, that this is a value of service pricing?

6 THE WITNESS:

7 A. Yes.

8 Q. Okay.

9 (PAUSE)

10 Q. I'm going to take another minute or two,
11 because I think I can eliminate some questions that have
12 been asked.

13 (PAUSE)

14 Q. On page 31 of your testimony on line 8; and
15 this is where we were talking about AEP using the Black-
16 Scholes option pricing model to calculate the value of its
17 POLR obligation.

18 Do you know of any other utility Company
19 today that prices its POLR by using a Black-Scholes model
20 approach?

21 A. I have not done that analysis.

22 Q. So, to the best of your knowledge your answer
23 is "no"?

24 A. Well, I... the way you couched the question,
25 I thought what you were saying is that do we believe others

1 are doing it and I may have misread your question.

2 Q. Oh, no, if that was the case, let me rephrase
3 the question.

4 Do you know of another utility that has used
5 Black-Scholes to price it's POLR?

6 A. I do not know of any, but that in no way
7 should be read to mean that there aren't.

8 Q. Right, and we'll agree that you've done no
9 study to go look for them, it's just that that's the state
10 of your understanding today?

11 A. That's fair.

12 Q. Okay.

13 (PAUSE)

14 Q. Okay. Now, if you would, turn to page 33 of
15 your testimony.

16 (PAUSE- WHILE WITNESS REVIEWS DOCUMENT)

17 A. All right, I'm there.

18 Q. And, actually it starts at the bottom of...
19 no, the line I want to draw your attention starts at the
20 bottom of page 32 and it says;

21 "It is also important to remember that
22 Black-Scholes... that the Black-Scholes
23 model also uses AEP's proposed ESP
24 prices and the estimation of the
25 competitive retail electric service

1 prices as a direct inputs."

2 And, I was wondering how you developed---

3 A. I'm sorry.

4 Q. ---that if---

5 A. I'm sorry, I am...

6 (PAUSE)

7 A. I'm lost as to where we are.

8 Q. Oh, okay. Let's go to page 32 of your---

9 A. Okay.

10 Q. ---of your testimony.

11 A. Yeah.

12 Q. Line 16, the very bottom.

13 A. Okay.

14 Q. And, I'm going to read you the sentence as
15 much for my benefit... or maybe more for my benefit than
16 yours. But, the sentence says;

17 "It is also important to remember that
18 Black-Scholes... that the Black-Scholes
19 model also uses AEP's proposed ESP
20 prices and the estimation of the
21 competitive retail electric service
22 prices as a direct inputs."

23 A. Yes, I say that.

24 Q. Right. And, my question for you was, how you
25 developed the competitive retail electric service estimates?

1 (PAUSE)

2 A. Those are what we used in the MRO calculation
3 and it was the table that had all of the costs and we looked
4 at it based on customer classes.

5 Q. Okay.

6 A. It's the---

7 Q. So, the... when I think of MRO, I think of
8 the MRO as basically a wholesale power price. And, when I
9 think of competitive retail electric service, CRES service,
10 I think of a retail price.

11 Is your testimony then that the list of costs
12 that are in your MRO chart that funnels this down to a
13 retail price?

14 A. Yes.

15 Q. Okay.

16 (PAUSE)

17 BY HON. PETRICOFF:

18 I believe that those are all the questions I
19 have for you, Mr. Baker, and I really appreciate your
20 spending not only your Saturday, but your vacation with us
21 in delivering your testimony.

22 THE WITNESS:

23 Okay. I'm glad I could get it out of the
24 way.

25

1 HON. RESNIK: Sharon, Mr. Baker will read
2 the transcript. When would you expect to
3 have that prepared?

4 COURT REPORTER: Okay. Can I... and I do
5 need a little bit of input in here.

6 Obviously this has been... this was set up
7 at the last minute, I understand that and
8 there are parameters on me; and Mrs. Roberts
9 you can correct me if I'm wrong in this, in
10 understanding your Secretary only wants to
11 order your Direct Examination of Mr. Baker?

12 (PAUSE)

13 COURT REPORTER: Mrs. Roberts.

14 HON. ROBERTS: I'm thinking.

15 (PAUSE)

16 HON. ROBERTS: Howard, were you going to
17 need this deposition?

18 HON. PETRICOFF: Yeah, I'm going to need
19 it too and if your... and if the next
20 question was, do you want to buy one and
21 split it, the answer is "yes".

22 HON. ROBERTS: Oh, okay. That would be
23 great. So, we want the entire deposition.

24 COURT REPORTER: So, y'all are splitting
25 the costs on this, so there is no other

1 copy on this then?

2 HON. PETRICOFF: Right, one would be...

3 one would be fine. I guess the only

4 other question would be, if... could we

5 get it on an expedited basis?

6 COURT REPORTER: Yes, that's all been

7 discussed, but it was discussed based on

8 how long the thing the thing took and

9 whether it was an excerpt of just the

10 direct and all this other stuff, so

11 I'm totally confused. But, I think it

12 was ordered that they wanted it in two

13 days, and I always assumed at all times

14 that was business days, since that's

15 what we were talking about, so it would

16 be done by Tuesday.

17 HON. PETRICOFF: As you can tell, you

18 better be afraid with this group when

19 you talk about business days, because

20 we consider Saturday one.

21 COURT REPORTER: Well, honey, I work

22 every Saturday too. And, not doing

23 this necessarily, that's just catching

24 up typing.

25 HON. PETRICOFF: Well, that's right.

1 You've already proven that by being
2 here.

3 COURT REPORTER: And, I apologize for
4 stumbling over the reading backs, but
5 I had no idea we were going to get
6 into the acronymology (sic), since
7 y'all create other words too, of what
8 all we were talking about and until
9 I settle in and know where in the
10 world we're... you know, what we're
11 talking about it's very hard, but....

12 HON. PETRICOFF: Absolutely, and did
13 you get that we have a passion for
14 acronyms.

15 COURT REPORTER: Well, I understand
16 that, there were some words there I
17 I heard some "iations" on that I've
18 never heard of before. But, anyway,
19 how long is Mr. Baker down here, when
20 do you want him to read and sign it;
21 or I mean do you want to just handle that
22 when he gets back up there?

23 HON. RESNIK: I tell you what, once we're
24 off line why don't you work out with Mr.
25 Baker as to the best way to get the

1 transcript to him, you know, and he'll
2 need some period of time to read it
3 regardless of where he is.

4 COURT REPORTER: Right.

5 HON. RESNIK: You know, whatever the
6 normal time is and I'll let you work
7 out with him.

8 THE WITNESS: Well, Mark, let me just
9 take up logistics here. If this isn't
10 going to be available until Tuesday,
11 then I'm going to be back in Columbus
12 Wednesday night and I'll be... so, the
13 chance of me being able to---

14 COURT REPORTER: So, I don't need to
15 interrupt your vacation anymore with
16 that.

17 THE WITNESS: You know, and on Wednesday
18 is not really highly likely.

19 HON. RESNIK: So, Sharon, can I give
20 you my address and you can send the
21 transcript to me for Mr. Baker to
22 read?

23 COURT REPORTER: Now, you're 1 Riverside
24 Plaza?

25 HON. RESNIK: Yes.

1 COURT REPORTER: 29th Floor, Columbus.

2 HON. RESNIK: Yes.

3 COURT REPORTER: Give me your phone
4 number as well, would you please?

5 HON. RESNIK: The office number is
6 (614) 716-1606.

7 COURT REPORTER: Okay. All right. And,
8 Mr. Petricoff, you don't need anything;
9 correct?

10 HON. PETRICOFF: No, but when you send it
11 to the OCC, I'm assuming you're going to
12 send them the rough draft on close of
13 business Tuesday as well.

14 COURT REPORTER: They're not getting the
15 rough draft, honey, they're getting the
16 whole thing. I mean it will be over by
17 then.

18 HON. RESNIK: The unread version.

19

20 (NO FURTHER EXAMINATION)

21 (CONCLUDED @ 10:55 P.M. CDT)

22

23

24

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1	CORRECTIONS			
2	PAGE	LINE	READS	SHOULD READ
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1 SUBSCRIPTION

2 I, J. CRAIG BAKER, the undersigned, have read the
3 foregoing deposition under oath consisting of 125 pages, and
4 do hereby acknowledge that the answers are true and correct
5 to the best of my knowledge, and that the same is a true and
6 correct transcript of the questions and answers except as
7 noted on the attached errata sheet (corrections).

8

9 DATED this ____ day of _____, 2008.

10

11 _____ J. CRAIG BAKER

12

13 STATE OF _____)

14 COUNTY OF _____)

15 SWORN TO AND SUBSCRIBED before me this

16 ____ day of _____, 2008.

17

18 _____

19 Notary Public

20

21

22 My Commission Expires:

23

24

25

CERTIFICATE OF OATH

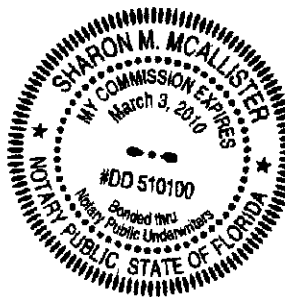
STATE OF FLORIDA

COUNTY OF BAY

I, Sharon M. McAllister, Notary Public, the undersigned authority, certify that J. CRAIG BAKER personally appeared before me and was duly sworn.

WITNESS my hand and official seal this 25th day of October, 2008.

Sharon M. McAllister



1 CERTIFICATE

2 STATE OF FLORIDA

3 COUNTY OF BAY

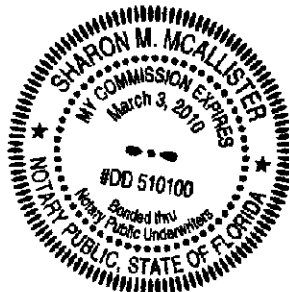
4 I, SHARON M. McALLISTER, Court Reporter and
5 Notary Public in and for the State of Florida at Panama
6 City, Florida do hereby certify as follows:

7 THAT I correctly reported the foregoing
8 deposition/testimony of J. CRAIG BAKER at the time and place
9 therein designated in the caption hereof;

10 THAT I later reduced my shorthand notes to
11 typewriting and that the foregoing pages numbered 1 through
12 127 contain a full, true and correct transcript of the
13 proceedings taken on said occasion;

14 THAT I further am neither of kin nor of
15 counsel to any of the parties involved in this matter, nor
16 am I interested in the results thereof;

17 THIS 28th day of October, 2008.



SHARON M. McALLISTER

Court Reporter & Notary Public
State of Florida at Large

25 My Commission Expires: